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Supreme Court of The United States

OCTOBER TERM, 1980

No. 80-

LOMAS & NETTLETON FINANCIAL CORPORATION, et al.,

Petitioners,

v.

GEARLD CLARK, et al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Does a federal court, as a matter of federal law and policy, lack the power to approve the settlement of a shareholders derivative action over the objections of plaintiff-shareholders alleging violations of section 12 of the 1933 Securities Act, sections 10 and 14 of the 1934 Securities Exchange Act, and pendent state claims, because two shareholders who together hold a majority of the corporate shares have been named as defendants, when the federal district court specifically finds that the settlement is: (i) negotiated without fraud or collusion by six disinterested and independent nondefendant directors; and (ii) is fair, adequate, and reasonable, and in the best interests of the corporation?

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Petitioners Booth, Inc., Lomas & Nettleton Financial Corporation, The Lomas & Nettleton Company, Lomas & Nettleton West, Inc., Jess T. Hay, Albert Rohnstedt, DeWitt T. Ray, John Sexton, and James B. Gardner respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on August 28, 1980.

OPINIONS BELOW

The opinions of the district court are reported at 79 F.R.D. 641 (N.D. Tex. 1978) and 79 F.R.D. 658 (N.D. Tex. 1978) (Porter, J). The court of appeals' opinion reversing the district court is reported at 625 F.2d 49 (5th Cir. 1980),

with an earlier opinion dismissing the plaintiffs' appeal from an interlocutory order reported at 581 F.2d 516 (5th Cir. 1978) (per curiam). All four opinions and the judgment and denial of rehearing by the court of appeals are reproduced in the appendices to this petition.

JURISDICTION

The judgment of the court of appeals was entered on August 28, 1980, and a timely petition for rehearing and suggestion for rehearing en banc was denied on November 7, 1980. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) (1966).

STATUTES AND RULES INVOLVED

Section 12 of the Securities Act of 1933, 15 U.S.C. § 77L (1971); section 10(b), 15 U.S.C. § 78j(b) (1971), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1980), and section 14(a), 15 U.S.C. § 78n(a) (1971), and Rule 14a-9 promulgated thereunder, 17 C.F.R. 240.14a-9 (1980) of the Securities Exchange Act of 1934; section 33(A) of the Texas Securities Act, Tex.Rev.Civ.Stat.Ann. art. 581-33(A) (Vernon 1964); section 27.01 of the Texas Business and Commerce Code, Tex. Bus. & Com. Code Ann. tit. 3, § 27.01 (Vernon 1968); article 2.31 of the Texas Business Corporation Act, Tex. Bus. Corp. Act Ann. art. 2.31 (West 1976); and Federal Rule of Civil Procedure 23.1, Fed.R.Civ.P. 23.1.

STATEMENT OF THE CASE

This shareholders' derivative action was filed on July 27, 1973. Plaintiffs have alleged violations of section 12 of the Securities Act of 1933, sections 10 and 14 of the Securities Exchange Act of 1934, and state laws. The five plaintiff-

shareholders have named seventeen defendants and have sought damages both individually and derivatively on behalf of former shareholders of NCS Computer Corporation (NCS) as it existed prior to a 1973 merger.[1]

Plaintiffs' derivative action essentially involves allegations concerning the 1969 issuance and sale of shares of NCS, a computer software company, to defendant Lomas & Nettleton Financial Corporation (LNFC), allegedly induced by a simultaneous NCS-LNFC computer servicing contract. The derivative action also alleges securities acts violations in connection with three NCS proxy solicitations, one of which, on April 17, 1973, resulted in the merger of NCS and Booth, Inc., a soft drink dispenser manufacturer. NCS, a small but publicly held company, was the surviving corporation after this merger, and adopted the name Booth, Inc.

After extensive discovery, and following a January 9, 1978 pre-trial hearing, all parties agreed to hold settlement discussions and — at the suggestion of plaintiffs' counsel — met before the district court. In these discussions, the plaintiffs refused to consider any settlement of the corporate derivative claims without a simultaneous settlement of their individual claims. When the plaintiffs advanced this position, the six nondefendant directors of Booth, Inc., none of whom had been accused of any wrongdoing, and all of whom were concerned about never having had an opportunity dutifully to make a disinterested business judgment about the case, *Clark v. LNFC,* 79 F.R.D. 641, 645 (N.D. Tex. 1978), *rev'd,* 625 F.2d 49 (5th Cir. 1980), negotiated a settlement of the derivative action on behalf of the corporation to

[1]The district court found in an April 29, 1977 order that the derivative action was being brought on behalf of the corporation surviving the merger, petitioner Booth, Inc. *Clark v. Lomas & Nettleton Financial Corp.*, 79 F.R.D. 641, 646-48 (N.D. Tex. 1978), rev'd on other grounds, 625 F.2d 49 (5th Cir. 1980).

propose to the district court and shareholders for consideration and approval.[2] Jack J. Booth, the one director who was a named defendant and the holder of forty-five per cent of Booth, Inc.'s common stock, did not participate in any way in either the negotiations or the board's approval of the proposed settlement. Under the proposed settlement, Booth, Inc. was to receive $415,000.00, the 258,983 shares (or approximately eleven per cent) of its common stock which defendant LNFC owned (with a current public market value of approximately $582,711.00), and the release of certain defendants' indemnification claims estimated at $250,000.00 to $400,000.00.

All of Booth, Inc.'s shareholders were notified of the proposed settlement, with the notice containing a full explanation of the plaintiff-shareholders' objections to the settlement, as required by Fed.R.Civ.P. 23.1. The district court then allowed the plaintiff-shareholders full discovery into the settlement negotiations and held an evidentiary hearing on June 5, 1978. None of the 1,951 non-party shareholders of Booth, Inc. objected in any way to the proposed settlement. Two plaintiff-shareholders testified at the trial court's evidentiary hearing on the settlement that the Booth, Inc. shareholders come out very well by the proposed settlement and obviously would not object. All five plaintiff-shareholders, however, opposed the proposed settlement, contending, among other things, that a class composed of NCS shareholders before the 1973 merger, which included themselves, should recover any derivative settlement proceeds, rather than Booth, Inc.

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[2] Although the district court's opinion reflects the plaintiffs' awareness of and opportunity to participate in these ongoing, judicially supervised settlement negotiations, see 79 F.R.D. at 645, the court of appeals wrote that the settlement negotiations had taken place "[w]ithout the presence or knowledge of [the plaintiffs] ...." 625 F.2d at 53.

THE DISTRICT COURT'S OPINION

The district court after reviewing the record, which included broad discovery into the settlement negotiations, and holding an evidentiary hearing, found that the six nondefendant directors were disinterested, that they did not lack independence or have a conflict of interest, that the settlement had not been framed to insulate Jack J. Booth, the one director defendant, that there was no evidence of collusion in the settlement, and that the settlement was fair, reasonable, and adequate, and in the best interests of the corporation.[3] Furthermore, the district court found that the plaintiffs refused to consider any settlement of the derivative claims apart from their individual claims, wanted any settlement proceeds to be distributed to former shareholders of NCS, including themselves, rather than to Booth, Inc., and did not (at all times) act in Booth, Inc.'s best interests.[4] Accordingly, the district court approved the proposed settlement, severed the plaintiffs' individual claims from the derivative claims, and entered a final judgment on the derivative claims pursuant to Fed.R.Civ.P. 54(b).

THE COURT OF APPEALS' OPINION

The court of appeals held that the six nondefendant directors were incompetent as a matter of law to compromise the plaintiffs' derivative claims because "Jack Booth's and LNFC's combined shareholdings [and their power to elect Booth, Inc.'s directors] may have influenced the settlement terms,"[5] and that the Booth, Inc. directors' "conflict of interest could not be cured by judicial approval of the settlement terms."[6]

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[3] See 79 F.R.D. at 649-53, 657.

[4] See *id.* at 652, 656-57.

[5] 625 F.2d at 53.

[6] *Id.* at 54.

In spite of the district court's express reservation of decision on the sufficiency of the plaintiffs' demand upon Booth, Inc.'s directors to institute litigation (a 1974 post-merger "demand" that the directors bring an action on behalf of the class of pre-merger NCS stockholders against unnamed defendants), the court of appeals presumed that any "demand" for corporate action pursuant to Fed.R. Civ.P. 23.1 would have been futile because controlling shareholders were named defendants. 625 F.2d at 53.

The court of appeals reasoned from this presumption that nondefendant directors were incompetent to negotiate the compromise of derivative claims brought upon behalf of the corporation where named defendants held a majority of the corporation's stock, and that therefore, as a rule of law, a federal court had no power to approve any compromise such nondefendant directors proposed, regardless of the settlement's good faith and fairness. *Id.* at 53-54.

REASONS FOR GRANTING THE PETITION

I. The court of appeals' decision conflicts with this Court's holding in Burks v. Lasker, 441 U.S. 471, 99 St.Ct. 1831 (1979), that federal courts should apply state law governing independent directors' authority to discontinue derivative suits to the extent consistent with the policy of the federal statutes underlying the action.

Under Texas law, Booth, Inc.'s board of directors controls Booth, Inc.'s litigation and possesses inherent authority to compromise actions brought on the corporation's behalf. Tex. Bus. Corp. Act. Ann. art. 2.31 (West 1976). *Burks v. Lasker* viewed these corporate directors' litigation decisions to be limited only by federal policy and the applicable state law, and mandated the propriety of the procedures followed

by disinterested board members to protect the corporate interest in this case. 99 S.Ct. at 1840-41.

Accordingly, in *Abbey v. Control Data Corp.*, 603 F.2d 724, 730-32 (8th Cir. 1979), *cert. denied,* 100 S.Ct. 670 (1980), and *Lewis v. Anderson,* 615 F.2d 778, 783-84 (9th Cir. 1979), *cert. denied,* 49 U.S.L.W. 3249 (Oct. 6, 1980), the Eighth and Ninth Circuits held that the federal securities acts' underlying policies did not override the exercise of corporate directors' independent business judgments under state law. In *Galef v. Alexander,* 615 F.2d 51, 64 (2d Cir. 1980), the Second Circuit expressly declined to disagree with the Ninth Circuit in *Lewis v. Anderson,* but did preclude interested defendant directors from dismissing a derivative action for no consideration as a matter of federal policy.

In contrast, the district court in this case, after an extensive review of the record, found that the directors who proposed the settlement were disinterested and independent and that they had no conflict of interest in negotiating a settlement which was fair and not framed to insulate defendant director Jack J. Booth from liability.[7] In this case, the district court also expressly reserved any decision on whether the plaintiffs ever made a proper demand upon the directors for corporate action and thus never decided whether such a demand would have been futile.[8]

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[7] See 79 F.R.D. at 649-50, 652-53, 657, 661.

[8] *Id.* at 651; 625 F.2d at 51 n.2. Of the six directors who negotiated the settlement on behalf of the corporation, only two had been directors when plaintiffs made their purported 1974 "demand." Plaintiffs' 1974 letter had "demanded" an action against unnamed defendants, not on behalf of the corporation, but on behalf of a class of former shareholders. Of these six directors who proposed the settlement in the course of their fiduciary duty, only one was a corporate employee, and only one other could possibly be called a "consultant" by being a member of the corporation's law firm.

The Texas Supreme Court has expressly reserved ruling on the issue of whether, under Texas law, directors who are free from improper influence can have a derivative suit dismissed (with no consideration flowing to the corporation) where the plaintiff establishes good cause for failing to demand that the corporation bring suit. *See Murray Savings Association v. Zauber,* 601 S.W.2d 940, 941 (Tex. 1980) (per curiam), *aff'g writ ref'd n.r.e.,* 591 S.W.2d 932 (Tex. Civ. App. — Dallas 1979); *compare also Cramer v. General Telephone & Electronics Corp.,* 582 F.2d 259, 274-77 (3rd Cir. 1978), *cert. denied,* 439 U.S. 1129 (1979).

However, a trial court's power to examine and approve a derivative or class settlement that is free from fraud or collusion, and is fair and reasonable, has long been established as both a matter of federal judicial policy and Texas law, regardless of whether a plaintiff's demand on a board of directors to institute litigation may be procedurally futile. *Miller v. Republic National Life Insurance Co.,* 559 F.2d 426, 428-29 (5th Cir. 1977); *Young v. Katz,* 447 F.2d 431, 433 (5th Cir. 1971). There is no federal policy or Texas law which remotely suggests that a trial court has no power to authorize a settlement proposed by directors whom the trial court finds were independent, which it finds was negotiated without collusion and conflict of interest, and which it finds was fair and reasonable, if the trial court also finds that it is in the best interests of the corporation and its shareholders. Even if any Texas law to the contrary existed, and petitioners know of none, "federal courts must be ever vigilant to insure that application of state law poses 'no significant threat to any identifiable federal policy or interest . . . .'" *Burks v. Lasker,* 99 S.Ct. at 1838, *quoting Wallis v. Pan American Petroleum Corp.,* 384 U.S. 63, 68 (1966).

In any event, the Fifth Circuit bases its opinion and holding not on Texas law, but upon federal procedural

requirements, presuming that the demand upon directors contemplated by Fed.R.Civ.P. 23.1 was futile because controlling shareholders had been named as defendants, and thus that any settlement initiated by the corporation's directors could not, as a rule of law, be approved by a federal court. *Clark v. LNFC,* 625 F.2d at 53. At the outset, the Fifth Circuit's holding, in its premise that a federal court must conclusively presume the "futility" of a plaintiff's demand where controlling shareholders are named defendants, conflicts with the Second Circuit's opinion in *Elfenbein v. Gulf & Western Industries, Inc.,* 590 F.2d 445 (2d Cir. 1978) (per curiam). In *Elfenbein,* 590 F.2d at 450-51, the Second Circuit held that one defendant's ownership of a twenty-seven per cent, allegedly controlling, stock interest did not raise the presumption that the majority of directors would breach their fiduciary duty and thus did not create the presumption of the futility of a demand to sue. *See also Heit v. Baird,* 567 F.2d 1157, 1162 (1st Cir. 1977).

Most importantly, the Fifth Circuit's opinion also conflicts with cases decided by this Court over the last seventy-five years, which hold that the corporation is the real party in interest in a derivative action and that the corporate board, not the stockholder-plaintiff, has the power and duty to protect the corporation's rights in the litigation subject to judicial scrutiny of the propriety of its actions. *United Copper Securities Co. v. Amalgamated Copper Co.,* 244 U.S. 261, 263-64 (1917); *Corbus v. Alaska Treadwell Gold Mining Co.,* 187 U.S. 455, 463 (1903); *Burks v. Lasker,* 99 S.Ct. at 1841.

As the Ninth Circuit has held, in a derivative action, the plaintiff-stockholder's "position . . . is assimilated to that of a guardian ad litem with power in the court, not in the stockholder, to compromise the rights of the real party in interest, which is the corporation itself . . . ." *Denicke v. Anglo California National Bank,* 141 F.2d 285, 288 (9th Cir.), *cert. denied,* 323 U.S. 739 (1944). To hold otherwise

— which the Fifth Circuit has done here as a rule of law — renders the corporate entity powerless to protect itself in derivative actions, and "put[s] too much power in a wishful thinker or a spite monger to thwart a result that is in the best interests of the corporation and its stockholders." *Saylor v. Lindsley*, 456 F.2d 896, 900 (2d Cir. 1972).

II. The court of appeals' decision conflicts with its prior decisions in Miller v. Republic National Life Insurance Co., 559 F.2d 426 (5th Cir. 1977), and Young v. Katz, 447 F.2d 431 (5th Cir. 1971).

The Fifth Circuit and all other circuits have long held that in class and derivative actions:

> Settlement agreements are "highly favored in the law and will be upheld whenever possible because they are a means of amicably resolving doubts and preventing lawsuits".... In class actions this policy must be coupled with the two-fold requirement that (1) there is no fraud or collusion in arriving at the settlement and (2) the settlement is fair, adequate and reasonable, *Young v. Katz*, 5 Cir. 1971, 447 F.2d 431, 433....
>
> The approval of settlements in class actions is left to the sound discretion of the district court. A decision to approve will not be disturbed on appeal unless it is clearly shown that the approval resulted from an abuse of discretion. *Young v. Katz, supra.*

Miller v. Republic National Life Insurance Co., 559 F.2d 426, 428-29 (5th Cir. 1977). These rules for settlement which were enunciated in *Young* and *Miller* apply to derivative actions brought pursuant to Fed.R.Civ.P. 23.1. *See Burks v. Lasker*, 99 S.Ct. at 1841 n.16; *Clark v. LNFC*, 625 F.2d at 54; *see also* 7A C. Wright and A. Miller, *Federal Practice and Procedure: Civil* § 1839, at 427, 435-36 (1972);

3B *Moore's Federal Practice* § 23.1.24[2] at 136-39 (2d ed. 1980); *compare also Ford v. Bimbo Corp.*, 512 S.W.2d 793 (Tex.Civ.App. — Houston [14th Dist.] 1974, no writ).

Nevertheless, the Fifth Circuit, without setting aside the district court's specific findings of fact that the directors acted independently, and without fraud or collusion, and that the settlement was fair, adequate, and reasonable, has promulgated its rule of law nullifying these established federal court procedures for controlling derivative settlements merely because of a compulsory presumption that the "combined shareholdings [of Jack J. Booth and LNFC] may have influenced the settlement terms." *Clark v. LNFC*, 625 F.2d at 53. The Fifth Circuit's rule thus prohibits a federal court from examining and approving a derivative settlement over a shareholder's objection in every case where majority shareholders are merely named as defendants.

The court of appeals did not and could not set aside the district court's findings upon this record as an abuse of discretion or otherwise. Thus, despite the district court's express findings of good faith and fairness in this case, the Fifth Circuit has stripped federal courts of their power to examine and approve any derivative settlement proposed by nondefendant directors. Rather, the Fifth Circuit has given plaintiff-shareholders the authority and the power to preclude any federal trial court from scrutinizing settlements proposed by directors by merely naming majority shareholders as defendants. In short, the court of appeals has created a *per se*, irrebuttable, presumption prohibiting the federal courts' scrutiny and approval of any derivative action settlement in which majority shareholders have been but merely named as defendants.

III. The court of appeals' per se rule which disqualifies directors from proposing a derivative settlement where majority shareholders are named defendants conflicts with United States Supreme Court and Fifth Circuit decisions holding that fraud should not be presumed.

In *Saenz v. Kenedy,* 178 F.2d 417, 419 (5th Cir. 1949), the Fifth Circuit stated that "fraud is never presumed and must always be proven by clear and convincing evidence." In this case, the district court reviewed the extensive record and found no fraud or collusion by the six directors negotiating the settlement. Without setting aside the district court's findings of fact on the settlement's good faith and fairness, the court of appeals concluded that there is an overriding legal presumption of collusion and fraud in the conduct of nondefendant directors who propose the settlement of derivative actions where majority shareholders are named defendants. *Clark v. LNFC,* 625 F.2d at 54.

In *Burks v. Lasker,* the Second Circuit had similarly concluded that "mutual fund directors can never be truly disinterested in suits involving their codirectors." 99 S.Ct. at 1840 n.15. In *Burks,* this Court rejected that presumption, as it should here reject the Fifth Circuit's irrebuttable presumption of nondefendant directors' fraud and wrongdoing, stating: "While lack of impartiality may or may not be true as a matter of fact in individual cases, it is not a conclusion of law. . . ." *Id.* at 1840-41 n.15.

IV. The court of appeals' decision conflicts with the federal judicial policy that places the power to approve class and derivative settlements in the federal district courts.

This Court should make clear that in the federal system the power to examine and approve a derivative settlement

resides in the federal court, not in self-appointed plaintiff-shareholders, not in directors, not in an "executive committee,"[9] and not in any other party or extra-judicial group.

The impact of the court of appeals' ruling which strips federal courts of their power to control settlements in this common type of derivative action where large shareholders are named defendants can scarcely be overstated. The Fifth Circuit's *per se* rule removes a trial court's control over settlement in every derivative suit in which majority shareholders are defendants, regardless of: (1) how independent the district court finds that the settling directors are; (2) how fair the settlement is for the corporation and its shareholders; (3) how free of fraud or collusion the settlement is; and (4) how unreasonable the plaintiffs' objections are. In short, the court of appeals' ruling destroys the federal courts' ability to override the objections of any self-appointed plaintiff-shareholders, no matter how unreasonable or how selfishly motivated, despite findings that a settlement is in the best interests of the corporation and its shareholders.

Thus, this decision completely contravenes the strong public policy favoring settlements. The Fifth Circuit has effectively ruled that this action and similar actions can never be settled over the plaintiff-shareholders' objections. The Fifth Circuit's rule of law holds corporations and federal courts hostage to the demands of plaintiff-shareholders in every case where large shareholders are named defendants. No matter how unreasonable, self-interested, or destructive of corporate interests the plaintiffs may be, they can prevent the federal courts from approving a fair and favorable settlement.

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[9]The Fifth Circuit declined to comment on a "duly constituted executive committee's" authority to compromise derivative claims in the instant case. *Clark v. LNFC*, 625 F. 2d at 54 n.6.

The Fifth Circuit's rule of law creates an irrebuttable, *per se* presumption of fraud and collusion on the part of corporate directors where named defendants hold large stock interests. It effectively deprives every federal court of its control over and its power to review and approve settlements which are in all respects negotiated in good faith, fair, and in the best interests of the corporation.

CONCLUSION

In this case, the district court had the benefit of a full record, including broad discovery on the proposed settlement agreement prior to the hearing. Reviewing the record, the district court found that the settlement was not collusive or fraudulent, that it was fair, adequate, and reasonable, and that it was negotiated by disinterested, independent directors for, and in the best interests of, the corporation.

In sum, in this case the directors have been found as a fact to be disinterested and independent and to have made a good faith determination that a settlement of a derivative action was fair, adequate, and in the best interests of the corporation and its shareholders. The court of appeals has not set aside these extensive findings of fact by the trial court.

The court of appeals nevertheless has held that federal courts have no power to approve a settlement found to be in good faith and fair because of a newly created, irrebuttable, *per se* presumption of wrongdoing by corporate directors in federal derivative actions where majority shareholders are named defendants.

This court of appeals' decision violates prior decisions of this Court and decisions of the Fifth and all other circuits. It presents an important question of federal law concerning

both the power of every federal court to approve settlements of derivative actions brought under the federal securities laws and the deference which federal courts should give to the inherent powers of corporate management.

For the foregoing reasons, a writ of certiorari should issue to the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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APPENDIX A

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT VACATING AND REMANDING CAUSE TO THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

Gerald CLARK et al.,
Plaintiffs-Appellants,

v.

LOMAS & NETTLETON FINANCIAL CORPORATION et al.,
Defendants-Appellees.

625 F.2d 49 (5th Cir. 1980)

No. 78-2973.

United States Court of Appeals,
Fifth Circuit.

Aug. 28, 1980

Appeal from the United States District Court for the Northern District of Texas.

Before SIMPSON, HILL and HATCHETT, Circuit Judges.

JAMES C. HILL, Circuit Judge:

NCS Computer Corp. [NCS], a Texas corporation, was formed in 1968 to develop and market computer software. The following year, Lomas & Nettleton Financial Corp. [LNFC] allegedly acquired "control" of NCS by inducing it to issue shares in consideration of a service contract that, it is alleged, LNFC never intended to perform. Once in

"control," LNFC allegedly set about to "dismantle" NCS, installing its own slate of directors who allegedly permitted LNFC to dishonor its contract with NCS while LNFC developed internal data processing capability. By 1972, LNFC apparently was in a position to compete directly with NCS, whose active operations meanwhile had been drastically curtailed. Merger discussions began with Booth, Inc. [Old Booth], a closely held vendor of soft drink dispensers that was interested in NCS's liquid assets. In 1973, Old Booth and NCS agreed to merge in a stock/stock transaction, NCS surviving. The merger terms provided that LNFC would purchase NCS's computer related assets. The entity that was NCS took on the name Booth, Inc. [Booth], continuing the soft drink dispenser business inherited from Old Booth, and exiting altogether from the data processing field.

Within two months of the NCS-Old Booth merger, several Booth shareholders commenced the instant action. The original complaint, directed solely at pre-merger events, charged LNFC and related persons with various securities frauds, 15 U.S.C.A. §§ 78j, 78n (West 1971); 17 C.F.R. §§ 240.-10b-5, 240.14a-9 (1979), and pendent state law omissions. Appellants sued both individually and derivatively on behalf of Booth. *See* Fed.R.Civ.P. 23.1. In respect of the derivative claims, although "demand" had not been made on them,[1] Booth's directors evidently were content to allow appellants to proceed. The company, a nominal defendant, answered simply by stating that recovery under the derivative claims should accrue to it. Beyond that, the company apparently took no active part in the early litigation.

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[1] Appellants' original complaint alleged that demand had been made on the NCS board prior to the NCS-Old Booth merger, which demand allegedly had been refused.

Following some eighteen months of discovery, and a second fruitless "demand" on Booth's directors,[2] appellants sought to amend their complaint so as to attack the NCS-Old Booth merger, and specifically the sale of NCS's computer related assets to LNFC. The merger, appellants charged, resulted from proxy misstatements allegedly made by LNFC's "captive" NCS managers, and by which LNFC allegedly was enabled to obtain NCS's computer related assets at distress prices. To these new claims, all derivative in nature, Booth again answered neutrally that recovery thereunder should accrue to it. Actual pursuit continued as before through appellants' sole efforts, neither assisted nor opposed by Booth.

In 1976, appellants again sought to amend their complaint, this time to join certain Old Booth officials — one of whom became and remains Booth's president and largest shareholder — as aiders and abettors of LNFC. Then, three years into the litigation, appellants met their first resistance from Booth. In contrast with its response to appellants' second complaint, Booth now prayed that the district court deny leave to amend. Some months later, after amendment was permitted, Booth joined with the newly named individuals in moving to dismiss the counts against them. This motion also was denied. Appellants meanwhile continued to prepare for trial in January, 1978.

One week before trial was to begin, Booth once more entered the fray, this time to terminate all of the derivative claims by settling them. Without the presence or knowledge of appellants, Booth representatives met with the various defendants and reached an overall compromise

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[2] There apparently exists a dispute over the sufficiency of appellants' second "demand" on Booth's directors. The district court expressly reserved judgment on the question, which in any event does not bear on our decision.

within three days. In substance, the compromise provided that LNFC would tender to Booth all of its shares in that company; that LNFC would pay Booth $415,000 cash; and that various former NCS officials would waive indemnification claims against Booth. Booth's directors ratified the compromise, and over appellants' vigorous objections the district court "tentatively" approved it pending an evidentiary hearing on fairness and adequacy. As required by Rule 23.1, Booth shareholders were notified of the proposed settlement. None (other than plaintiffs) objected. The evidentiary hearing occurred, at which the parties argued principally over the value of appellants' chances of success on the merits and the disinterest of Booth's directors. "[A]fter a thorough review of the entire record," the district court determined both that the board was disinterested and that "the settlement amount and the terms are adequate, fair and reasonable." *Clark v. Lomas & Nettleton Finance Corp.*, 79 F.R.D. 641, 652 (N.D.Tex.1978). This appeal followed.

As the district court apparently recognized, the threshold question is whether Booth's directors possessed authority, vel non, to determine that the corporation should compromise appellants' derivative claims. At first blush, it would seem anomalous that corporate directors could tardily and peremptorily intervene to extinguish shareholder derivative actions, over the plaintiffs' heads and despite their objections. But while the propriety of such intervention may be questioned, the power can not be. Appellants' action is "derivative" because the rights asserted belong not to them but to Booth, Inc. Corporate litigation policy — whether to enforce corporate rights of action — plainly constitutes part of the "business and affairs," Tex.Bus.Corp. Code § 2.31 (Vernon 1980), that corporate directors primarily manage. *See Square 67 Development Corp. v. Red Oak State Bank,* 559 S.W.2d 136,

138 (Tex.Civ.App.1977).[3] On this premise, which is neither extraordinary nor novel, courts have repeatedly held that corporate directors are empowered to abort putative shareholder derivative suits, when it is their business judgment that the case ought not be enforced. *See, e. g., United Copper Securities Co. v. Amalgamated Copper Co.*, 244 U.S. 261, 362-64, 37 S.Ct. 509, 510, 61 L.Ed. 1119 (1917) (Brandeis, J.); *Lewis v. Anderson*, 615 F.2d 778, 781-82 (9th Cir. 1979); *Abbey v. Control Data Corp.*, 603 F.2d 724, 729-30 (8th Cir. 1979), *cert. denied*, —— U.S. ——, 100 S.Ct. 670, 62 L.Ed.2d 647 (1980); *Cramer v. General Telephone & Electronics Corp.*, 582 F.2d 259, 273-78 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129, 99 S.Ct. 1048, 59 L.Ed.2d 90 (1979); *Auerbach v. Bennett*, 47 N.Y.2d 619, 631, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 927 (1979); *Zauber v. Murray Savings Association*, 591 S.W.2d 932, 936 (Tex.Civ.App. 1979). Correlatively, corporate directors possess inherent authority to compromise such suits. See *Saylor v. Lindsley*, 456 F.2d 896, 899-900 (2d Cir. 1972) (Friendly, J.); *Denicke v. Anglo California National Bank*, 141 F.2d 285, 288 (9th Cir.), *cert. denied*, 323 U.S. 729, 65 S.Ct. 44, 89 L.Ed. 592 (1944).

As with other management functions, however, the power to control corporate litigation presupposes that the directors have no interest in its exercise. *See Galef v. Alexander*, 615 F.2d 51, 58-61 (2d Cir. 1980); *Maldonado v. Flynn*, 413 A.2d 1251, 1263 (Del.Ch.1980). *See generally* Note, *The*

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[3] Although plaintiffs assert federal claims, this and similar matters of internal corporate power are in the first instance controlled by state law. *See Burks v. Lasker*, 441 U.S. 471, 477-80, 99 S.Ct. 1831, 1836-1838, 60 L.Ed.2d 404 (1979). Booth is a Texas corporation, and in the absence of any contrary suggestion by either party we shall assume that Texas law supplies the pertinent rules of decision. *Cf. Jefferson Pilot Broadcasting Co. v. Hilary & Hogan, Inc.*, 617 F.2d 133, 135 (5th Cir. 1980).

Business Judgment Rule in Derivative Suits Against Directors, 65 Cornell L.Rev. 600 (1980). We must further inquire, therefore, whether in negotiating the compromise Booth's directors stood "in a dual relation [that] prevent[ed] an unprejudiced exercise of judgment." *United Copper Securities,* 244 U.S. at 264, 37 S.Ct. at 510, quoted in *Galef,* 615 F.2d at 60. *See, e. g., Ash v. International Business Machines, Inc.,* 353 F.24 491, 493 (3d Cir. 1965), *cert. denied,* 384 U.S. 927, 86 S.Ct. 1446, 16 L.Ed.2d 531 (1966); *Swanson v. Traer,* 249 F.2d 854, 858-59 (7th Cir. 1957). In this connection, appellants point out that co-defendant Jack Booth — one of the Old Booth officials joined in 1976 — is president, a director and the largest Booth shareholder. Mr. Booth and LNFC together own a majority of Booth's outstanding shares. Booth's charter forbids cumulative voting, and it is undisputed that each and every director who ratified the compromise was elected by Jack Booth's and LNFC's combined vote.[4] A majority of those directors, moreover, were insiders. Jack Booth and LNFC wielded power to strip them not only of directorates, but of officer and consultant positions as well. Nor can we ignore the possibility of "structural bias" in this case, *see* Note, *supra,* 65 Cornell L.Rev. at 619-22, suggested by Booth's sudden hostile reaction to Mr. Booth's joinder.

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[4] Booth's April, 1977 proxy statement states as follows:

> On March 7, 1977, the only shareholders known to own of record and/or beneficially more than 10% of the outstanding common stock of the Company were Jack J. Booth, who owns 1,107,424 shares of record (approximately 45%) and Lomas & Nettleton Financial Corporation, which owned 258,983 shares of record (approximately 11%). The Company has been advised that both Jack J. Booth and Lomas & Nettleton Financial Corporation intend to vote their shares in favor of the election of the nine directors proposed by management. . . .

The district court forthrightly confronted the conflicts question, but in the end did little more than state its conclusion that the new Booth board was disinterested:

> The Board of Directors of Booth, Inc. that approved the settlement of the derivative action was comprised of different individuals than those who occupied those positions at the time of [the acts complained of] . . . . The fact that LNFC and Jack Booth have controlled more than 50% of the stock of Booth, Inc. since May 10, 1973 does not, by itself, establish that the Board of Directors of Booth, Inc. were unable to make an independent judgment about the settlement proposal. Jack Booth was specifically excluded from the Board meeting and did not vote on the settlement proposal.
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> . . . . . .
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> . . . [T]he majority of the 7 man Board of Directors of Booth, Inc., was disinterested. Jack Booth, the only defendant on the Board, was excluded from the Board meeting by Booth's lawyer.

Clark v. Lomas & Nettleton Financial Corp., 79 F.R.D. 641, 649-50 (N.D.Tex.1978). The preceding discussion simply does not address appellants' main point, which is that Jack Booth's and LNFC's combined shareholdings may have influenced the settlement terms. It is irrelevant that Jack Booth did not vote on the compromise proposal as a director; appellants' objection looks to his status as a shareholder.

We are guided by cases excusing the "demand" requirements of Rule 23.1. *See generally* Note, *Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. Chi. L. Rev. 168 (1976); *Note, Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73

Harv. L. Rev. 746 (1960). It is generally held that shareholders may sue derivately, without first demanding that the directors enforce the corporate cause, when the circumstances would render such demand a futile gesture. *See, e.g., Elfenbein v. Gulf & Western Industries, Inc.,* 590 F.2d 445, 450 (2d Cir. 1978) (per curiam); *In re Kauffman Mutual Fund Actions,* 479 F.2d 257, 263 (1st Cir.), *cert. denied,* 414 U.S. 857, 94 S.Ct. 161, 38 L.Ed.2d 107 (1973); *Liboff v. Wolfson,* 437 F.2d 121, 122 (5th Cir. 1971) (per curiam). Where as here, the controlling shareholders are named defendants, demand "futility" is presumed:

> The court should not cajole itself into the believing that the members of a Board of Directors elected by the dominant and accused majority stockholders, after accusations of wrongdoing have been made, were selected for membership on the Board to protect the interests of the minority stockholders and to assure a vigorous prosecution of effective litigation against the offending majority.

Cohen v. Industrial Finance Corp., 44 F.Supp. 491, 494 (S.D.N.Y.1942), quoted in *deHaas v. Empire Petroleum Co.,* 286 F.Supp. 809, 814-15 (D.Colo.1968), *modified on other grounds,* 435 F.2d 1223 (10th Cir. 1970). *See Abbe v. Goss,* 411 F.Supp. 923, 924-25 (S.D.N.Y.1975) (demand on directors excused where three defendants owned 44% of the outstanding shares); *In re Penn Central Securities Litigation,* 367 F.Supp. 1158, 1164-65 (E.D.Pa.1973) (demand on directors excused where one defendant owned 80% of outstanding shares). To excuse demand in these cases was effectively to hold that the directors were incompetent to decide that the action should not be brought. Their business judgment became irrelevant to the plaintiffs' standing, for it never was consulted. We hold, by a parity of reason-

ing,[5] that Booth's directors were incompetent themselves to compromise all of appellants' derivative claims.[6]

The preceding conclusion compels that we vacate the compromise. The board's conflict of interest could not be cured by judicial approval of the settlement terms. "Fairness," "reasonableness" and "adequacy" in this context connote only that the terms fall within a range of magnitude that the directors, in the exercise of their business judgment, could legitimately accept. This "range of reasonableness," *Lewis v. Newman*, 59 F.R.D. 525, 529 (S.D.N.Y.1973) (Weinfeld, J.) quoting *Newman v. Stein*, 464 F.2d 689 (2d Cir.) (Friendly, J.), *cert. denied*, 409 U.S. 1039, 93 S.Ct. 521, 34 L.Ed.2d 488 (1972), plainly may encompass terms that, while apparently "fair," may nonetheless have suffered

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[5] By looking to cases excusing the "demand" requirements of Rule 23.1, we do not mean necessarily to equate the showing of interest that would excuse such "demands" and that necessary to vitiate subsequent director action. The former is more rigorous. *See Galef v. Alexander*, 615 F.2d 51, 59 (2d Cir. 1980); *Heit v. Baird*, 567 F.2d 1157, 1162 n. 6 (1st Cir. 1977). To the extent that cases excuse shareholder "demands" on facts comparable to those at hand, they apply a fortiori to subsequent director action.

[6] We observe that Mr. Booth is not implicated in all of appellants' charges, and particularly those involving pre-merger events. We need not now decide whether, given the dynamics of Mr. Booth's and LNFC's respective shareholdings and litigation interests, Booth's directors lawfully could compromise those counts in which Mr. Booth is not named. Nor does this case present any issue respecting whether, under Texas law, a duly constituted executive committee could have achieved what the directors unsuccessfully attempted. *E. g., Lewis v. Anderson*, 615 F.2d 778 (9th Cir. 1979); *Abbey v. Control Data Corp.*, 603 F.2d 724 (8th Cir. 1979), *cert. denied*, – U.S. –, 100 S.Ct. 670, 62 L.Ed2d 647 (1980); *Rosengarten v. International Tel. & Tel. Corp.*, 466 F.Supp. 817 (S.D.N.Y.1979); *Gall v. Exxon Corp.*, 418 F.Supp. 508 (S.D.N.Y. 1976). *See generally* Note, *supra*, 65 Cornell L.Rev. at 608-16.

from incestuous negotiation. It is indeed for this very reason that we bifurcate our review of derivative settlements, *see Miller v. Republic National Life Insurance Co.*, 559 F.2d 426, 428-29 (5th Cir. 1977); *Young v. Katz*, 447 F.2d 431, 432-33 (5th Cir. 1971), by focusing on conflicting interests independently of the terms themselves. Our holding pretermits review of whether the terms actually negotiated were "reasonable" in relation to the claims surrendered. That question will arise, if ever, only when this case is settled by parties unbeholden to the alleged wrongdoers.

VACATED and REMANDED.

APPENDIX B

ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS APPROVING SETTLEMENT

Gearld CLARK, Tom Burden, Ronald Brandow, Robert Burnside and Wayne Burnside

v.

LOMAS & NETTLETON FINANCIAL CORPORATION, the Lomas & Nettleton Company, Lomas & Nettleton West, Inc., NCS Computing Corp., now known as Booth, Inc., Jess T. Hay, L & N Computer Services, Inc., John Sexton, Albert Rohnstedt, Dewitt T. Ray, Guy W. Rucker, Robert E. Glaze and James B. Gardner, et al.

79 F.R.D. 641 (N.D. Tex. 1978)
No. CA3-7465-F.

United States District Court,
N. D. Texas,
Dallas Division.

Aug. 7, 1980.

ROBERT W. PORTER, Judge.

Scientists, philosophers, theologians and a few ordinary mortals have long speculated about the origin of the universe. Scientists have recently concluded by using sophisticated measuring equipment and employing various theories regarding the relationship between matter and energy that the source of creation (as far back as science can trace) was a tight ball of hydrogen which split apart in all direc-

tions in a "big bang", slowly condensing to form stars and planets which are still traveling at great speed from the source of the explosion. The "big bang" wiped out any definitive answers to the question "what created the tight ball of hydrogen?" and scientists must also speculate about what will happen to all of the disbursed bits and particles scattered around the universe by the "big bang", although many scientists believe that the particles will condense in a few billion years and then perhaps explode again.

The history of this case has paralleled the creation of the universe. Unlike the cosmological events, we can date precisely the beginning of this event, but, like the creation of the universe from the condensed mass and as is the case in all litigation, it is impossible to know exactly what transpired before that date (though the lawyers would argue that they have accumulated more evidence on that question in this case than the scientists have discovered about what came before the date of the "big bang" explosion).

The *Clark* case began on July 27, 1973 when the Plaintiffs filed a 12 page securities fraud complaint requesting individual and derivative relief. The Plaintiffs sought recovery, allegedly on behalf of NCS Computing Corporation (hereinafter "NCS") against Defendants Lomas & Nettleton Financial Corporation (hereinafter "LNFC"), its two wholly owned subsidiaries, The Lomas & Nettleton Company (hereinafter "L & N") and Lomas and Nettleton West, Inc. (hereinafter "L & N West"), Hay, Sexton, Ray, and Rohnstedt as a result of their alleged violations of Section 10(b) and Rule 10b-5 and Section 27.01 of the Texas Business and Commerce Code in connection with the sale by NCS to LNFC of 350,000 shares of common stock of NCS in January of 1969 (all of the allegations now summarized are taken from Plaintiffs' Third Amended Complaint).

Plaintiffs also sought recovery against Defendants Gardner, Glaze, Hay, Rucker and Sexton, as well as LNFC as a controlling person, for their role in preparing and soliciting proxies for voting at the annual meeting of shareholders of NCS held on October 8, 1971. In addition Plaintiffs charged that Defendants Gardner, Glaze, Sexton and LNFC (as a controlling person) improperly prepared and solicited proxies for the annual meeting of NCS shareholders held on September 20, 1972.

Count 9 of the Plaintiffs' Third Amended Complaint sought recovery against Defendants LNFC and L & N West based upon said Defendants' alleged breach of a servicing agreement (Ex. A to the Third Amended Complaint). Plaintiffs also sought recovery derivatively against LNFC, L & N, L & N West, Ernst and Ernst, Busbee, Rogers, Sexton, Hay, Glaze, Gardner, Tannery, Jack Booth, Whitmer and Crow for alleged violations of Section 10(b), Rule 10b-5, Section 14, Rule 14a-9, and Section 12 of the Securities Act of 1933.

Plaintiffs finally sought derivative recovery against Defendants LNFC, L & N, L & N West, Hay, Sexton, Ray, Rohnstedt, Glaze, Gardner, Rucker and Ernst and Ernst for breach of fiduciary duties owed to NCS Computing Corp. and its minority public shareholders.

Defendants contend that the fact that no mutually acceptable operating agreement was ever entered into or executed by the parties was due to the incompetency of the principals in NCS and the Defendants contend that under the circumstances they did everything possible to cooperate in the preparation of an agreement. Defendants also contend that as a matter of law they did not breach the Servicing Agreement, that all contractual obligations were performed and they assert, as affirmative defenses, accord and satisfaction, novation, estoppel, waiver, ratification, recission and sub-

stitution of a new and separate agreement, fraud and failure of consideration.

Defendants deny all of the Plaintiffs' factual allegations regarding the sale of the 350,000 shares of stock, and claim that the Plaintiffs cannot prove any of the essential elements necessary to establish liability under 10b-5. Defendants also contend that the 1971, 1972 and 1973 proxies were true and correct and that there were no material omissions. They deny all liability with respect to these solicitations. Certain Defendants also claim that the Plaintiffs are not entitled to sue derivatively because they allegedly failed to comply with the requirements of Rule 23.1 of the Federal Rules of Civil Procedure relating to making a demand upon the Board of Directors prior to bringing a derivative action.

The Defendants also deny any liability for any alleged violations of the Texas Securities Act or that they breached any alleged fiduciary duties, and claim that any alleged breaches of fiduciary duty are barred by the doctrine of laches and the statute of limitations.

Plaintiffs assert that for the alleged violations they have pleaded NCS and Booth, Inc. should be awarded substantial damages totaling millions of dollars. Defendants dispute Plaintiffs' computations of the alleged damages arguing that Plaintiffs and the corporation incurred no damages or only minimal damages. Defendants also contend that Plaintiffs' suit is brought derivatively on behalf of Booth, Inc., not NCS as NCS was merged out of existence, and therefore no recovery should or could as a matter of law be awarded to NCS.

This briefly summarizes the contentions of the parties and does not approach the particularity and detail used by the parties to fully explicate their positions.

The case exploded from these humble beginnings as each allegation in the complaint (and subsequent amended complaints) was analyzed, investigated and developed from all conceivable angles by the lawyers and the parties. According to the latest figures available (as of May 25, 1978), the litigation had expanded to include: depositions of 38 deponents totaling 12,730 pages of non-experts and 3,346 pages of experts; 431 deposition exhibits (1,243 pages) and 151 expert witness exhibits totaling 5,029 pages; 611 interrogatories totaling 210 pages; designation of 1,500 documents for trial (4,994 pages); and 18 pretrial briefs amounting to 1,503 pages, plus thousands of additional pages of motions, briefs, and orders totaling some 27 pages of docket entries.

The court has been extensively involved in overseeing the litigation; as I stated on February 24, 1978 (Transcript of Hearing February 24, 1978 at 14-15) "I feel confident that I could try this case from the standpoint of the plaintiffs or the defendants, and . . . I feel fully familiar with the case, both factually and substantively from the legal points involved . ." In considering the proposed settlement of the derivative claims in this case I have considered all of the papers, briefs, depositions and the entire record. While I must, of necessity, make reference to the voluminous record and address the arguments raised by counsel I will attempt to limit my references and comments to the essential.

Like the universe it is hard to tell when or where this "big-bang paper case" will end, though eventually I am confident that some court will reach a decision that condenses this verbal universe into a decision that resolves the entire dispute. Regrettably, this order will not accomplish that lofty aim, as I will only condense into a manageable settled form the derivative portion of the litigation.

TENTATIVE SETTLEMENT OF THE DERIVATIVE ACTION

On January 9, 1978 all counsel appeared at a pre-trial hearing in preparation for the then scheduled January 16, 1978 trial. At the conclusion of the discussion of various pre-trial motions filed by the parties the court inquired: "Let me ask you, Mr. Fichtner, do you have any observations on it or do you think it would be helpful to have a settlement conference with the Court?" (Transcript of Hearing January 9, 1978 at 90). Mr. Fichtner, one of the lawyers for the Plaintiffs, indicated that he would be "most pleased" to participate in a settlement conference with the court. All other counsel either voiced no objection to the discussion of settlement, or expressly indicated their desire to participate. (Transcript of Hearing January 9, 1978 at 90-92). Mr. Kirk, representing Booth, Inc., a nominal defendant in the case, specifically requested that he be present during any settlement negotiations "because I feel that the Plaintiffs' case involves two different causes of action, one individually and one supposedly on behalf of the company I represent ..." because he did not feel that the company had had an opportunity to make a disinterested business judgment as to the manner in which the case had been handled. *Id.* at 92. The court did not feel that Mr. Kirk's position barred his participation in settlement discussions with the court, and all parties recessed to participate at 3:30 that afternoon in an off-the-record settlement discussion with the court.

Settlement discussions continued over the next few days. At one point the court suggested to the Plaintiffs that they consider settlement of the derivative claims alone. Plaintiffs responded that they felt the entire litigation should be settled and they were not prepared to make a separate derivative claim demand. (See Transcript of Hearing June

5, 1978 at 70 for confirmation, although testimony not under oath). Booth, Inc. and the Defendants reached a tentative settlement of the derivative claims in the lawsuit and presented the tentative proposal to the court. The court indicated that the settlement as outlined appeared to represent a fair resolution of the derivative claims in the lawsuit, but the court would withhold entering formal tentative approval of the settlement until a disinterested majority of the Board of Directors of Booth, Inc. had had an opportunity to review the settlement and until the settlement proposal had been reduced to writing and signed by the participating parties. The proposal suggested to the court involved a payment to Booth, Inc. of approximately $400,000 cash, return to Booth of LNFC's holdings of Booth stock, and a release of certain indemnity claims. Plaintiffs violently objected to the settlement proposal.

Plaintiffs immediately objected, for the first time in the lawsuit, that Tim Kirk's participation in the lawsuit (along with his law firm of Saner, Jack, Sallinger and Nichols) on behalf of Booth, Inc. involved a conflict of interest. [For a complete analysis of this issue, see this court's order filed today discussing Kirk's alleged conflict of interest, Clark v. Lomas & Nettleton Financial Corp., 79 F.R.D. 658 (N.D.Tex. 1978)]. Over plaintiffs' objection the settlement offer was submitted to and approved by a majority of the board of directors of Booth, Inc. on January 11, 1978 (with Jack Booth not participating or being present at the Board meeting).

After the approval of the proposal by the board of directors of Booth, Inc. the court solicited the views of all counsel in preparing an appropriate notice to the stockholders. (See court's proposed draft of notice attached to order soliciting comment by all counsel, filed February 16, 1978). On February 16, 1978 the Plaintiffs filed extensive objections

to the proposed notice and one week later Plaintiffs filed extensive objections to any court approval of the settlement. On February 24, 1978 the court conducted an on the record hearing to review the parties' objections to the notice to the shareholders.

An executed copy of the settlement agreement was filed with the court on February 21, 1978, and on March 3, 1978 the court entered an order giving preliminary court approval to the settlement of the derivative claims in Counts III, IV, VII, VIII, IX, X, XI and XII of Plaintiffs' Third Amended Original Complaint asserted on behalf of Booth, Inc. and approved a form of notice to be sent to the shareholders of Booth, Inc.

The court adopted many of the suggestions made by the Plaintiffs in preparing the final notice to the shareholders. The court set the hearing on final approval of the settlement on June 5, 1978, three months after the court tentatively approved the settlement and form of notice. The court changed the record date to conform with the date of the court's order, March 3, 1978. The court changed the time of the hearing to 10:30 a.m. on June 5, 1978 at Plaintiffs' suggestion, and the court was prepared to allot more than one day to the hearing although the parties did not require the additional time. The court also included a more detailed description of the litigation, explained various terms of legal art so that they would be comprehensible to a layman, and made other changes consistent with the court's view that the notice sent to the shareholders should reflect the requests made by the parties for inclusion while being a fair and accurate statement of the litigation.

The court refused to send the notice to NCS shareholders as of April 2, 1973 or April 17, 1973 as requested by the Plaintiffs and as proposed in the court's original

draft. On April 5, 1977 the court conducted a hearing on motions to dismiss the derivative counts on grounds that the plaintiffs lacked capacity to sue derivately on behalf of "NCS as it existed prior to the merger." At that hearing Plaintiffs made conflicting statements about their cause of action. Mr. Mulloy stated:

> "Our basic position is that our suit is as representative of NCS as it now exists—Booth is NCS, so we are seeking derivative action on behalf of NCS as it now exists." (Transcript of Hearing April 5, 1977, p. 17, ll. 15-19)

On the other hand, when the court asked for clarification from Mr. Yeager, another attorney for the Plaintiffs, on this point he stated:

> "New Booth is in and Old Booth is in." (Transcript of Hearing April 5, 1977, p. 17, ll. 1-2) (Old Booth refers to NCS as it existed prior to the merger with Booth) After this hearing the court held in its order of April 29, 1977 that:

> "...the recovery which is sought is that for injury and damage to NCS as it existed prior to the merger which I have interpreted to mean New Booth (or in other words, Booth, Inc.)..." (Order of April 29, 1977, p. 6)

Plaintiffs argued in their objections to the proposed settlement and at the settlement hearing on June 5, 1978 that they were seeking to enforce through this derivative action the rights of NCS as it existed prior to the merger with Booth, that any recovery should go to the shareholders of NCS as of April 17, 1973, a date prior to the merger, and hence approval of the derivative claims settlement in this lawsuit should be received from the shareholders of NCS as of April 17, 1973.

A shareholder's derivative suit brought under Rule 23.1, Fed.R.Civ.Pro., is a procedure by which shareholders of a corporation can assert a right of action on behalf of the corporation when the corporation has refused a properly made demand to enforce the corporation's rights. *Koster v. Lumbermens Mutual Casualty Co.*, 330 U.S. 518, 67 S.Ct. 828, 91 L.Ed. 1067 (1947). Any recovery made by the shareholders in a successful derivative action goes to the corporation and the shareholders thereby benefit through their participation in the ownership of the company. *Ross v. Bernhard*, 396 U.S. 531, 90 S.Ct. 733, 24 L.Ed.2d 729 (1970); *Martens v. Barrett*, 245 F.2d 844 (5th Cir. 1957); *Green v. Victor Talking Mach. Co.*, 24 F.2d 378 (2nd Cir. 1928).

Justice Frankfurter explained the nature of a derivative suit in his dissent in *Smith v. Sperling*, 354 U.S. 91, 99, 77 S.Ct. 1112, 1119, 1 L.Ed.2d 1205 (1957):

> "The contrasting difference between a stockholder's suit for his corporation and a suit by him against it, is crucial. In the former, he has no claim of his own; he merely has a personal controversy with his corporation regarding the business wisdom or legal basis for the latter's assertion of a claim against third parties. Whatever money or property is to be recovered would go to the corporation, not a fraction of it to the stockholder. When such a suit is entertained, the stockholder is in effect allowed to conscript the corporation as a complainant on a claim that the corporation, in the exercise of what it asserts to be its uncoerced discretion, is unwilling to initiate. This is a wholly different situation from that which arises when the corporation is charged with invasion of the stockholder's independent right".

The capacity of a corporation to sue or be sued and hence the ability of its shareholders to sue on behalf of

the corporation or to sue the corporation, is determined by the law of the state of incorporation, Rule 17(b), Fed. R.Civ.Pro.; *Beam v. Monsanto Co. Inc.*, 414 F.Supp. 570 (W.D. Ark.1976). A corporation can only exist according to state law and in the capacity authorized by the state. *Chicago Title and Trust Co. v. Forty-One Thirty-Six Wilcox Bldg. Corp.*, 302 U.S. 120, 58 S.Ct. 125, 82 L.Ed. 147 (1937).

Plaintiffs have always alleged that, apart from their individual claims, they asserted "(c)ertain counts.... brought derivatively for and on behalf of NCS Computing Corp. as it existed prior to the merger." This language is contained in Plaintiffs' First, Second and Third Amended Complaints (See Appendix filed by Defendants LNFC et al. in Support of Motions to Dismiss, filed July 1, 1977, at 71, 79, and 125 for easy reference to all of Plaintiffs complaints).

In May of 1973 NCS and Booth merged and NCS Computing Corp. "as it existed prior to the merger" ceased to exist. Art. 5.06, Tex.Bus.Corp. Act (1976). The surviving corporation, Booth, Inc., possessed all of the rights and privileges, and was responsible for all of the liabilities and obligations of the merged corporation, including any claims existing at the time of the merger. *House Builders Inc. v. First Business Invest. Corp.*, 448 S.W.2d 829 (Tex.Civ. App.—Waco 1969, writ ref'd n.r.e.); *Morris Plan Life Insurance Co. v. Wells*, 387 S.W.2d 84 (Tex.Civ.App.—Ft. Worth, 1965, no writ). NCS no longer exists "as it existed prior to the merger" and the only entity that can enforce any rights NCS held prior to the merger is Booth, Inc. *Sun Pipeline v. Altes*, 511 F.2d 280 (8th Cir. 1975).

In arguing that the shareholders of NCS as of April 17, 1973 should participate in the settlement of this lawsuit, and in arguing that these individuals should be the recipi-

ents of any settlement proceeds derived from settling the derivative claims in this case, Plaintiffs are attempting to transform their lawsuit from a derivative action into a class action because the case law does not support Plaintiffs' position that shareholders of a corporation merged out of existence may bring a derivative action on behalf of the non-existent corporation.

The Plaintiffs would like the court to construe the word "derivative" in their Third Amended Complaint to read "class action", and they make this request, not after the court explicitly refused to entertain that interpretation on April 29, 1977 (Order filed May 2, 1978 — a more complete discussion of this issue is contained in this order), but literally on the eve of trial and after the court has been presented with a settlement proposal that would dispose of the derivative claims in this lawsuit. The federal rules contemplate a definitive distinction between a class action, see Rule 23, Fed.R.Civ.Pro., and a derivative action, see Rule 23.1 Fed.R.Civ.Pro.; the court cannot read the word "derivative" in the Plaintiffs' Third Amended Complaint as meaning "class action." To do so would dramatically alter the nature of this lawsuit, create unfair surprise to all of the Defendants, and amend de facto Plaintiffs' Third Amended complaint to assert a class action on the eve of trial without requiring compliance with the provisions of Rule 23.

Plaintiffs failed to plead their lawsuit in a manner consistent with their apparent intended aim. While the federal rules permit and require liberal construction and amendment of pleadings, see Rule 15, Fed.R.Civ.Pro., the rules do not grant Plaintiffs or Defendants unlimited rights of amendment. This litigation has consumed over 5 years of litigation. It was specially set for trial in November, 1977 and was specially reset for trial in January of 1978 be-

cause the Plaintiffs requested additional time to complete expert discovery and to meet the court's pre-trial deadlines.

Upon reviewing the entire history of this case, all of the pleadings permitted to date by the court, and the schedules for completion of certain pre-trial matters set forth in numerous orders by the court, I find that justice does not require the type of amendment the Plaintiffs seek at this late date in the case. Plaintiffs failed to plead what they had intended; they must live with their case as plead. Therefore the court correctly sent notice to only the shareholders of Booth Inc. because, as I ruled on April 29, 1977 and as I just ruled again, the derivative action was brought on behalf of Booth, Inc. and therefore any settlement recovery goes to the corporation Booth, Inc.

THE SETTLEMENT

Plaintiffs, as representatives of Booth, Inc., brought the derivative claims in this suit on behalf of the corporation. The corporation did not select these representatives of its cause of action; they were "self-chosen representative(s) and . . . volunteer champion(s)." *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 549, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949). The court must therefore determine whether any proposed settlement of the derivative claim is in the best interests of the corporation. This protects the corporation and its shareholders from unjust and collusive settlements. *Schlusselberg v. Colonial Management Associates, Inc.*, 389 F.Supp. 733, 741 (D.Mass.1974); *Birnbaum v. Birrell*, 17 F.R.D. 409 (S.D.N.Y.1955).

Because the court is entrusted with the power to finally approve or reject a proposed settlement of a derivative claim, the court may approve a settlement that does not meet with Plaintiff's approval. *Denicke v. Anglo California National Bank of San Francisco*, 141 F.2d 285 (9th

Cir. 1944), *cert. denied,* 323 U.S. 739, 65 S.Ct. 44, 89 L.Ed. 592 (1944). Other cases in the state and federal courts have repeatedly recognized that the primary question the court must answer in evaluating a settlement of derivative claims is whether the settlement is fair, adequate and reasonable. The court should consider the objections of any shareholders or the Plaintiffs made to the settlement proposal, but the court is not required to reject a settlement proposal solely because the settlement has failed to receive consensus approval of the parties and shareholders. See *Russell v. Weyland,* 42 P.2d 381, 5 Cal.App.2d 259 (Cal.App. 1935); *Bysheim v. Miranda,* Sup., 44 N.Y. S.2d 15 (1943); *Goodwin v. Castleton,* 19 Wash.2d 748, 144 P.2d 725 (1944); *Pergament v. Frazer,* 93 F.Supp. 13 (E.D.Mich. 1950); *Stella v. Kaiser,* 218 F.2d 64 (2nd Cir. 1954); *Republic National Life Insurance Co. v. Easley,* 73 F.R.D. 658 (S.D.N.Y. 1977).

In the notice sent by the court to the shareholders of Booth, Inc. (Order March 3, 1978) the court disclosed the terms of the proposed settlement of the derivative portion of this case and described the proper procedure for objecting to any of the terms of the settlement. The court stated:

> Any owner of Booth Inc. stock hereinabove described may appear at the hearing on June 5, 1978 in person or by attorney duly authorized in writing, and state objections they may have, if any, to the approval of the derivative settlement by the Court and entry of judgment by the Court dismissing and releasing all of the above-named defendants as to all derivative claims; provided, however, that no such person shall be heard by the Court except as the Court may in its discretion allow, unless on or before 5:00 p.m. May 25, 1978 such person files his written notice of intention to appear, along with a written statement of his position to be

asserted and grounds therefor, with the United States District Clerk . . ."

No shareholders of Booth, Inc. stock, other than the Plaintiffs, filed any objections to the proposed settlement by May 25, 1978 as instructed in the notice and no shareholders of Booth, Inc. stock, except the Plaintiffs, appeared at the hearing on June 5, 1978 seeking to object to the settlement. Only the Plaintiffs have objected to the court's approval of this derivative settlement. The terms of the settlement are fully set forth in the settlement agreement filed with the court on February 15, 1978.

PLAINTIFFS' OBJECTION TO THE SETTLEMENT

Plaintiff's primary objections to approval of the proposed settlement are: 1) the lack of independence and conflict of interest of the Board of Directors of Booth, Inc.; 2) the settlement is not fair, adequate and reasonable; 3) collusion in the negotiation of the settlement; 4) notice of the settlement should have been sent to NCS shareholders and the settlement proceeds should go to former shareholders of NCS stock, or a remedy should be constructed through the derivative action to undo the Booth/NCS merger and 5) the Saner, Jack Sallinger and Nichols law firm, as counsel for Booth, Inc., has a conflict of interest which should disqualify them as counsel in this case. I have rejected the Plaintiffs' fourth objection earlier in this order and I rejected the plaintiffs' request to disqualify the Saner firm in another order filed today. I will therefore discuss the Plaintiffs' first three objections to the approval of this settlement.

(1) Plaintiffs contend that the Board of Directors of Booth Inc. has a conflict of interest in approving any derivative settlement proposal. Plaintiffs note that: (1) the

Board of Directors was directly opposed to the primary relief sought by the Plaintiffs because it has consistently opposed recission of the Booth/NCS merger which the Plaintiffs contend was fradulent, (2) Defendants Jack J. Booth and LNFC have controlled the Board of Directors of Booth, Inc. since May 10, 1973 because they have continuously owned in the aggregate more than 50% of the Booth, Inc. stock and the Directors are not "independent" and (3) the Directors voting to approve the settlement owe their positions as Directors to the Defendants Jack J. Booth and LNFC.

The "evidence" cited by the Plaintiffs does not support the allegations of conflict of interest. The Board of Directors of Booth, Inc. that approved the settlement of the derivative action was comprised of different individuals than those who occupied those positions at the time of the merger or on the date when the Plaintiffs sent their "demand" letter to the Board. (See page 8-9 of the Memorandum Supporting Settlement filed by Booth, Inc. on May 25, 1978 for composition of the Board). The fact that LNFC and Jack Booth have controlled more than 50% of the stock of Booth, Inc. since May 10, 1973 does not, by itself, establish that the Board of Directors of Booth, Inc. were unable to make an independent judgment about the settlement proposal. Jack Booth was specifically excluded from the Board meeting and did not vote on the settlement proposal.

Lasker v. Burks, 567 F.2d 1208 (2nd Cir. 1978) cited by Plaintiffs to support their allegations of conflict of interest is distinguishable on its facts. In *Lasker* the Second Circuit reviewed the question of whether or not minority directors of a registered mutual fund who were nominated by the majority directors of the fund to be "independent" directors could terminate a non-frivolous stockholders' derivative action against the fund's majority directors and its

investment adviser. The board of directors in that case consisted of twelve members, *Id.* at 1210, fn. 5, and the board determined that five of its members were "disinterested" and should decide whether or not the derivative lawsuit should be pursued on behalf of the corporation. The five "disinterested" directors decided to seek dismissal of the suit from the court as a "business judgment". The Defendants moved to dismiss, and, after permitting discovery by the plaintiffs concerning the disinterested nature of the 5 minority directors, the court granted the requested dismissal. The Second Circuit reversed the trial court because it did not believe that a *minority* of directors appointed by a *majority* of a board of directors who, by their own admission, were interested parties, could truly make an independent business judgment with respect to *dismissal* of a case asserted on behalf of the corporation.

In *Clark* the majority of the 7 man Board of Directors of Booth, Inc. was disinterested. Jack Booth, the only defendant on the Board, was excluded from the Board meeting by Booth's lawyer.

The trial court in *Lasker* accepted the decision of the 5 members of the Board of directors because it concluded that they were disinterested, and made no independent review of the merits of the case, or the fairness, adequacy or reasonableness of what was, in effect, a settlement of the derivative action for no recovery. See *Lasker v. Burks,* 426 F.Supp. 844 (S.D.N.Y.1977); *Lasker v. Burks,* 404 F.Supp. 1172 (S.D.N.Y.1975). In *Clark* the court has been continually involved in overseeing the settlement of the case, and in this order has made detailed findings concerning the reasonableness, fairness and adequacy of the settlement.

Finally the Second Circuit, in a footnote, indicated that its decision was limited to the facts and circumstances of

this case. "We base our decision on the unique nature of the investment company and its symbiotic relationship with its investment adviser; we need not reach questions of the exercise of similar powers by directors of other types of corporations." *Lasker v. Burks,* 567 F.2d 1208, 1212 fn. 14 (2nd Cir. 1977). Booth is not an investment company and the Second Circuit's opinion would therefore not be applicable to the distinct facts of this case.

(2.) The test for determining whether or not the court should exercise its discretion and approve a proposed settlement of a derivative suit is whether the proposed settlement serves the best interest of the corporation. "A compromise will be approved as 'fair', 'reasonable', and 'adequate' if it serves that interest." *Zerkle v. Cleveland-Cliffs Iron Co.,* 52 F.R.D. 151, 159 (S.D.N.Y.1971); *Weiss v. Chalker,* 59 F.R.D. 533 (S.D.N.Y.1973); *Cannon v. Texas Gulf Sulphur Co.,* 55 F.R.D. 308 (S.D.N.Y.1972). Understandably the court does not undertake a trial on the merits to decide this question; the compromise was negotiated by the parties to avoid that result. *Schleiff v. Chesapeake and Ohio Railway Co.,* 43 F.R.D. 175, 178 (S.D.N.Y.1967); *Young v. Katz,* 447 F.2d 431 (5th Cir. 1971); *Neuwirth v. Allen,* 338 F.2d 2 (2nd Cir. 1964).

The case has been fully developed as can be observed by a brief glance at the 27 pages of docket entries and the complete pre-trial briefs filed by all parties at the insistence of the court. I have earlier cited the statistics developed by one of the parties concerning the extensive record in this case and at the court's suggestion, additional materials were filed with the court (including many extensive depositions and exhibits) for consideration by the court in connection with the June 5, 1978 settlement hearing. I cannot conceive of a more complete record at this stage of the proceedings.

In evaluating this settlement proposal the court has considered the entire record in this case on file with the court, and has evaluated the strength of the plaintiff's case balanced against the amount offered in settlement, recognizing that the fact that the settlement represents only a portion of the amount the Plaintiffs' claim or of the Plaintiffs' alleged potential maximum recovery does not, standing alone, establish that the offer is grossly inadequate or that it should be disapproved. *Schlusselberg v. Colonial Management Associates Inc.,* 389 F.Supp. 733 (D.Mass. 1974); *Feder v. Harrington,* 58 F.R.D. 171, 176 (S.D.N.Y. 1972).

The terms of the settlement are specifically set forth in the record in the settlement agreement. In summary that provides for payment in cash to Booth, Inc. of $415,000, the assignment by LNFC to Booth, Inc. of 258,983 shares of the common stock of Booth, Inc. which is all of the stock currently registered in LNFC's name, each party shall bear its own costs, and a number of the defendants waived their right of indemnification, if any, against Booth Inc. with all derivative claims asserted on behalf of Booth against the defendants being dismissed with prejudice.

Plaintiffs conclude that if the court approves this settlement, the case which began with a "bang" will end with a whimper. I have considered the amount of settlement in relation to what I consider to be Plaintiffs' probability of success on the merits, and I find that the amount and terms of the settlement are adequate, fair and reasonable. Plaintiffs have asserted causes of action on behalf of Booth which allege high damages. As the Plaintiffs and Defendants know, however, no contested lawsuit is ever a "sure thing". Plaintiffs would encounter numerous legal and factual problems in attempting to convince a jury and the court that they should be entitled to this pot of gold. The

Defendants filed detailed motions to dismiss and motions for summary judgment, which the court considered and overruled as of the time they were made. The Plaintiffs' won a temporary victory, but it is unclear whether they would prevail on these legal and factual points once the trial began. The court also specifically reserved decision on two crucial issues in its order overruling most of the Defendants' motions to dismiss and for summary judgment: 1) the viability of maintaining certain asserted implied causes of action and 2) the sufficiency of the demand made upon the Board of Directors of Booth Inc. Thus at the trial court level, after extensive review of the motions to dismiss and for summary judgment, as well as the pre-trial briefs in the case setting forth all of the facts and legal contentions of the parties, my best judgment is that the Plaintiffs do not have a good chance of success on the merits of their derivative claims.

Secondly, after reviewing the depositions of Plaintiffs' experts I am convinced that even if the Plaintiffs could overcome the legal and factual hurdles which they face in this case (and which, for purposes of brevity only, I will not set forth at length, but will refer instead to the pre-trial briefs filed by the Defendants, their motions to dismiss, and the briefs of the Defendants in support of settlement for a summarization of the problems) on liability, they have serious factual problems with establishing their damages alleged in their Third Amended Complaint. For example, the deposition of Chester Mills indicates that there would have been no cost savings to NCS until 1976. Dep. of Chester Mills, Vol. II, Jan. 14, 1978, pp. 394-396. And the actual cost of L & N's data processing, which Plaintiffs' contend NCS could have done for less than $4.91/loan/year apparently exceeded that amount from 1970 through 1976. Dep. of David Kelly, p. 429, Ex. 260A. I am aware that at the June 5, 1978 hearing the Plaintiffs attempted to clarify

Mills' testimony. My point in referring to these two examples is not to argue that in fact these figures are true, but merely to show that there are serious questions surrounding Plaintiffs' recovery of damages, and I must take these questions into account in determining whether the settlement is fair, reasonable and adequate.

I must also evaluate the length of trial and expense to the parties and balance that against the probability of Plaintiffs' success. Counsel, at various times, have indicated that this trial would likely last as long as 3 months, and I am inclined, based on my examination of the record, to agree with them. I am somewhat familiar with complex litigation, having completed only last year a 3 month antitrust trial which had fewer defendants and fewer issues than this case.

In court attorney time cost for such a case would be staggering. Reviewing the Plaintiffs' request for fees filed April 24, 1978 and, for purposes of estimation only, using it as a very rough guide to the legal expenses in this case that might be incurred by Booth, I could foresee Booth's legal expenses alone amounting to $500,000 and that would not include possible indemnification for the fees of other defendants in this litigation, all of which Booth risks with the distinct possibility of no recovery if the settlement is not approved and trial is commenced.

There are also a number of attorney conflict problems that I have perceived could arise in this case, aside from the question raised by the Plaintiffs concerning the disqualification of the Saner firm. The Defendants took the deposition of Jay Fichtner, one of the principal attorneys for the Plaintiffs, and it is not inconceivable to me that the Plaintiffs might feel it necessary to call him as a fact witness in this case. In addition, the Locke, Purnell firm was heavily involved in conducting the affairs of some of the

Defendants and their attorneys were involved in some of the transactions that occurred in this case (Busbee and Rogers, for example, who are represented by separate counsel, are members of the Locke, Purnell firm and are defendants in this suit because of their alleged involvement in the transaction). I could conceive that members of the Locke, Purnell firm other than Busbee or Rogers might need to be called to testify on behalf of the Defendants in this case. I raised these problems with all of the attorneys at the April 5, 1977 hearing and again in the fall of 1977 (see order filed October 19, 1977). Although the attorneys did not feel that a problem existed, if it arose at trial it could present serious problems under the Code of Professional Responsibility. See *Supreme Beef Processors, Inc. v. American Consumer Industries Inc.*, 441 F.Supp. 1064 (N.D.Tex.1977). This might result in trial postponement, disqualification of attorneys or even dismissal of the case, all to the detriment of Booth Inc.

Finally, I have considered that the Plaintiffs may not be fair or adequate representatives of Booth Inc.'s corporate interests, either at trial or in these settlement discussions. This point was first brought to my attention on January 3, 1977 in the Defendants LNFC, etc.'s brief in support of motions to dismiss, where Defendants pointed out that as Plaintiffs were asserting derivative *and* individual claims, they might impermissably use the leverage acquired through their control of the derivative suits to secure a favorable settlement of their individual claims, while at the same time failing to respect the interests of the corporation. Plaintiffs have repeatedly indicated that they saw no conflict with this representation, and I am not suggesting that such a conflict exists at this time. I can conceive that if this settlement was rejected that such a conflict might arise later in these proceedings, and I did observe that the Plaintiffs refused to even consider settlement of the deriv-

ative case apart from the individual claims. Transcript of Proceedings, June 5, 1978, pp. 70-71. The court can guard against this potential for conflict by closely overseeing the settlement of the lawsuit, and I believe that I have accomplished that aim.

It is my best judgment, after a thorough review of the entire record, and my conclusion that the settlement amount and the terms are adequate, fair and reasonable, given the Plaintiffs' chances of success, the complexity, length and expense of further litigation, the knowledge and experience of counsel who have spent 5 years with this case (as I have) and taking into consideration the opposition of the Plaintiffs and the lack of opposition from any other shareholder of Booth Inc.

(3) Finally, Plaintiffs complain that the settlement was collusive. I have reviewed the depositions of Kirk, Nichols, Booth, Osborne and Neely and I can find no evidence that the settlement was collusive in nature. All of the evidence suggests to me that the settlement was rather the result of hard bargaining between the parties. Plaintiffs suggest that the evidence shows that Booth's sole aim in this settlement was to eliminate any possibility of liability against Defendant Jack J. Booth. The only "evidence" of which I am aware to this effect is the statement by Mr. Wolfe in which he recounted his version of the settlement negotiations. See Transcript of Hearing, June 5, 1978. This monologue was not recited under oath, and I do not feel that it can be accepted by the court as evidence of anything except as counsel's argument to the court. I pointed out this problem to counsel (Transcript of Hearing June 5, 1978 at 66) but counsel elected to pursue the statement in the form now present in the record, and not to take the stand under oath where the Defendants would have the opportunity of effective cross examination.

Even if this statement were admissible evidence, however, Mr. Kirk's recollection of those events (which is in the record, see Kirk Deposition May 10, 1978 filed May 25, 1978, at 53, 11.16-17) and my own recollection of some of the events described by Mr. Wolfe differs from Mr. Wolfe's description. I find that Booth, Inc. was negotiating a fair settlement for the corporation and was not framed with a view to insulating Jack J. Booth from liability.

ATTORNEYS FEES

The Fifth Circuit has expressly approved the reimbursement of *reasonable* attorney's fees and expert witness' fees incurred in maintaining a derivative action which results in the creation of a fund benefitting the corporation. *Wolf v. Frank,* 477 F.2d 467 (5th Cir. 1973); *Wolf v. Frank,* 555 F.2d 1213 (5th Cir. 1977). The court should take into consideration the following 12 factors in analyzing the requested attorneys' fees: (1) the time and labor required, (2) the skill requisite to properly perform the legal services, (3) preclusion of other employment by the attorney due to acceptance of the case, (4) the novelty and difficulty of the questions presented, (5) the customary fee, (6) whether the fee is fixed or contingent, (7) time limitations imposed by the client, (8) the amount involved and the results obtained, (9) the experience, reputation, and ability of the attorneys, (10) the undesirability of the case, (11) the nature and length of the professional relationship with the client and (12) awards in similar cases. *Wolf v. Frank,* 555 F.2d 1213 (5th Cir. 1977); *Rainey v. Jackson State College,* 551 F.2d 672 (5th Cir. 1977); *Johnson v. Georgia Highway Express, Inc.,* 488 F.2d 714 (5th Cir. 1974). I have considered all of these factors in making my fee award determination in this case and more fully detail my views below.

Plaintiffs have requested counsel fees totalling $290,000 and reimbursement of expenses of $95,134.85 to be paid out of the settlement fund which Plaintiffs estimate totals $690,169.44. See Plaintiffs' Petition for Award of Fees and Costs, filed April 24, 1978 at 1 & 12. They claim to have expended a total of 10,108.5 recorded hours in the prosecution of this litigation, for which they would normally charge $964,975.00 on a non-contingent basis, and they estimate that 75% of the total hours expended are attributable to the derivative claims in this case, or 7,581.375 hours totalling $723,731.25, the remainder being attributable to the individual claims in this case which are not included in this settlement. Plaintiffs request compensation in the amount of only 40% of this total, or the $290,000 figure. Plaintiffs apparently request compensation for the full amount of their expenses. Defendants and Booth, Inc. have filed numerous objections to this award which I will address as I discuss the *Johnson* factors which I have considered in reaching my decision.

1. Time and Labor Required.

The Fifth Circuit has indicated that the number of hours claimed to have been expended in a case, here 10,108.5 hours, should not be the sole basis for determining a fee, and in fact Plaintiffs do not request full compensation for these hours, reducing their claim to 7,581.375 hours which they attribute to the derivative claims, and then arbitrarily requesting compensation for only 40% of that amount, or by their calculation $290,000. *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717 (5th Cir. 1974). I am convinced that the Plaintiffs have spent many hours preparing this case; I know that I have spent many hours in hearings, considering motions, and preparing orders. I perceive a real problem, however, in allocating the time as the Plaintiffs' request, 75% of the derivative claims and 25% to the individual claims, and in allocating

the costs, sometimes at the 75% figure and other times at another figure (for example, the expenses of Jacob Heffler are allocated at 85% to the derivative claims). Plaintiffs admit that this is only an estimate and I can find no supporting data in their fee requests for making any reasonable independent determination that their estimate is correct, or even substantially correct. Plaintiffs admit that Counts I and II (the individual claims for sale of securities) are virtually identical and would require development of essentially the same proof as Counts III and IV (derivative claims for sale of securities). Many of the facts, I find in reviewing the Third Amended Complaint, alleged in the derivative counts are also part of the individual claims, and would have to be proven to establish the individual claims for relief. I am not, therefore, convinced that the Plaintiffs' estimate is accurate, and Plaintiffs' should have kept accurate time records which distinguished between the time spent on the derivative claims, the time spent on the individual claims, and the time which the Plaintiffs believed was attributable to both the individual and derivative claims. This type of allocation should also have been used in recording the costs incurred in the litigation.

The Plaintiffs did exert substantial labor and effort in preparing this case for trial, including, but not limited to, three amended complaints, collection and inspection of thousands of documents, numerous oral depositions and compliance with the terms of this court's pretrial orders. In my judgment, however, in reviewing the settlement of this case, the Plaintiffs were expending substantial effort with only a very slim chance of recovery of the amounts stated in the Plaintiffs' Third Amended Complaint and only a minimal chance of recovery of any amount in connection with the derivative claims. Thus, with these odds, it is my judgment that the Plaintiffs expended an excessive number of hours and effort on the case. This evaluation would also apply to the costs incurred by the Plaintiffs.

2. Novelty and Difficulty of the Issues.

Plaintiffs assert that many of the issues presented by this case were novel and difficult, and therefore a substantial attorney fee award such as they request is justified. While I agree that there were some difficult issues in this case, I cannot ignore the fact that some of the issues might have been avoided (for example, the statute of limitations questions, the sufficiency of the demand on Booth, and the existence of implied remedies under Section 10 and 14). I am not suggesting that Plaintiffs erred in their conduct of the case, but I must review the conduct of the case, as overseer of the settlement, to determine if the fee request is reasonable.

I also believe that the Plaintiffs had weak legal arguments on a number of factual and legal points presented in the Defendants motions for summary judgment and in the motions to dismiss. I am not the ultimate arbiter of those questions if any of the parties were to appeal my decision on any of those issues should the case proceed to trial, but I believe it is important for me to review the strength of Plaintiffs arguments in determining whether the issues presented to me were really novel and complex, or whether other courts had either settled or marked the pathway for decision on these questions.

My judgment on this factor, however, has not had an overriding influence on my fee determination, as I recognize that a securities case, by its very nature, is a complex animal, and a substantial fee is justified for successful pursuit of the case.

3. Skill Requisite to Perform Proper Legal Services.

I have thoroughly examined the attorneys' work product in this case and observed the conduct of the Plaintiffs'

attorneys in this case and I can say without any qualification that they all possess superior ability, and that a securities case, of the type involved here, demands the top quality representation that the Plaintiffs' attorneys brought to bear in this case. On the other hand, I do not feel that this factor is determinative of what amount of fees should be awarded in this case, though obviously high quality work should be compensated, but should rather be considered along with all of the other factors.

4. Preclusion of Other Employment.

I am aware that this suit has, in all likelihood, precluded other employment on behalf of the Plaintiffs, though the record does not reflect any specific instances of employment rejected by the Plaintiffs because of the pendency of this suit. On the other hand, Plaintiffs chose to accept this employment knowing that they might not recover any amount on behalf of the corporation or might recover less than they had plead, and knowing that pursuit of a securities case involves a substantial expenditure of time and effort. They were also aware that the court would have to approve their requested attorneys' fees, and that they might not be awarded fees which equalled what they would bill a regular client for the number of hours expended in the case, or equal their requested fee.

5. The Customary Fee.

Here I will discuss the customary fee and awards in other cases, as I feel these two factors are related in a securities derivative action. In evaluating the customary fee for this type of case I have taken into account the stage at which this derivative action was settled, hourly fees requested by the Plaintiffs for their lawyers and assistants, my knowledge of the legal community and the customary fees charged by lawyers and experts as well as the evidence in

this case with regard to these items, and fee awards in other cases. The customary fee is also tied to the benefit conferred on the corporation and it has been held that that is the principal factor, though not the only factor, in determining a fee award in a derivative action. See *Murphy v. North American Light and Power Co.*, 33 F.Supp. 567, 570 (S.D.N.Y.1940); *Newman v. Stein*, 58 F.R.D. 540, 550 (S.D.N.Y.1973); *Derdiarian v. Futterman Corp.*, 254 F. Supp. 617, 620 (S.D.N.Y.1966); *In re King Resources Co. Securities Litigation*, 420 F. Supp. 610, 630 (D.Colo. 1976); *Voege v. Ackerman*, 70 F.R.D. 693 (S.D.N.Y.1976); *Blank v. Talley Industries Inc.*, 390 F. Supp. 1 (S.D.N.Y. 1975).'

In reviewing these cases and others, as well as commentaries on the subject, I find that the "usual" recovery approximates 20% of the benefit received by the corporation. Cole, *Counsel Fees in Stockholder's Derivative and Class Actions-Hornstein Revisited*, 6 Univ.Rich.L.Rev. 259, 281 (1972); Kennedy, *Securities Class and Derivative Actions in the United States District Court for the Northern District of Texas: An Empirical Study*, 14 Hous.L.Rev. 769, 820 (May 1977); Hornstein, *The Counsel Fee in Stockholders' Derivative Suits*, 39 Colum.L.Rev. 784, 813, n.187; Mowrey, *Attorney Fees in Securities Class Action and Derivative Suits*, J.Corp.Law 267, 349 (Winter 1978). In appropriate circumstances, however, courts have departed from this "customary" approach and awarded higher or lower fees. *In re Equity Funding Securities Litigation*, 438 F.Supp. 1303 (C.D.Cal.1977) (fee of 11% of recovery); *Zinman v. Avemco Corp.*, CCH Fed.Sec.L.Rev. P. 96, 325 (E.D.Pa.1978) (fee 50% of recovery). So I do not consider the percentage recovery in other cases a strict rule, but more a guideline.

I also consider the "usual" fee for hourly compensation to be a guideline and not fixed. I note however, that few, if

any, courts use the hourly compensation rate times the number of hours spent on the case by the Plaintiffs as the method of determining appropriate fees in a securities derivative count; that is certainly not the ultimate fee test. If I adopted that procedure here, for example, according to the Plaintiffs I would be awarding a fee to the Plaintiffs that would exceed their estimate of the recovery by over $300,000.

6. Fixed or Contingent Fee.

There is no dispute that Plaintiffs only recovery of fees for the work expended on the derivative portion of this lawsuit will be from the funds awarded to the Plaintiffs by the court, and that therefore their recovery of fees is contingent. I have taken this into account in computing the fees awarded, recognizing both that the Plaintiffs have expended many hours of uncompensated time (to date uncompensated) which have helped result in a recovery to the corporation, and that this will be the sole source of Plaintiffs' fees.

7. Time Limitations.

No time limitations imposed by the client occurred in this case to my knowledge, though, as pointed out by the Plaintiffs, the court did impose certain time limitations on the parties to bring this litigation to a close as it had been pending for a number of years. Contrary to the Plaintiffs' assertions, the court, in reviewing these time limitations, does not find them severe. In fact, the first pretrial order entered in this case in 1977, as I recall, was drawn with reasonable time limitations which were amended a number of times to accommodate the Plaintiffs, including postponement of trial for 2½ months, over the objections of the Defendants who were prepared for trial in November, 1977. In a case that has progressed for 5 years and is one of the

oldest cases on my docket, I do not feel persuaded that the court should award "some premium" for this effort, and though I do not ignore Plaintiff's efforts and take them into account in my decision, I don't feel they deserve an extra bonus as Plaintiffs suggest for any "hardship" suffered.

8. Amount Involved/Results Obtained.

This is one of the most important factors in my fee and cost award decision, because the lawsuit was brought to benefit the corporation, not to benefit the lawyers. The only benefit Plaintiffs claim they conferred on Booth, Inc. is the $415,000 cash and 258,983 shares of Booth, Inc. Common Stock (valued approximately by the Plaintiffs at $275,169.44) and I will accept their evaluation of the settlement for the fee award as any other benefit to the corporation is admittedly speculative, and hard to assess in accurate dollar amounts. I note, however, that for purposes of my evaluation of the reasonableness, adequacy, and fairness of the settlement I have taken into account the cancellation and waiver of some Defendants' claims for indemnification, which have been speculated to be worth from between $250,000 to $400,000. Plaintiffs do not request that I consider this amount in awarding their fees, and therefore I do not consider it.

Booth has incurred expenses as a result of this litigation and is likely to incur additional expenses to indemnify officers and directors under the premerger corporate charter of NCS. In some cases I believe that these expenses were imposed on Booth by the Plaintiffs, who brought the action on Booth's behalf, because certain Defendants were joined in the litigation which may not have been properly before the court.

Plaintiffs have also vigorously opposed the settlement (including, I note, one appeal already to the Fifth Circuit for which they are claiming attorneys' fees and costs in their petition for fees from the settlement proceeds), asserting that the proceeds should not go to Booth, Inc., claiming that the settlement amount was too low, and refusing to consider settlement of the derivative claims apart from their individual claims. Thus I believe that the Plaintiffs were not at all times acting in the best interests of the corporation, and it would not be proper to fully compensate them for pursuing interests adverse to the corporation they benefited, Booth, Inc., from the settlement proceeds to be received by Booth.

On the other hand, their efforts have helped prepare the case for trial which has resulted in a settlement favorable to Booth, Inc. and therefore their efforts should not be ignored, as counsel for Booth, Inc. suggests in its brief. I am not convinced, however, that the actions of the Plaintiffs contributed solely to this settlement; in fact, settlement would not have come about if Tim Kirk had not negotiated with the Defendants on behalf of Booth, Inc. And as I have concluded that the settlement is fair, reasonable and adequate for Booth, I cannot look as favorably on Plaintiffs' request for fees when they did not actively pursue the settlement that was negotiated, but instead incurred fees and expenses actively opposing the settlement. I must also take all of this into consideration when I evaluate Plaintiffs' request for cost reimbursement and I have done so.

In making my award, I also note that Mr. Fichtner, one of the Plaintiffs' principal attorneys, has been a shareholder of Booth, Inc. as well as a Plaintiffs' attorney in this lawsuit (Mr. Fichtner's deposition was even taken in this case). I have a serious question as to whether a stockholder or his law firm instituting a derivative action should

be allowed compensation as an attorney in the litigation. *Eisenberg v. Central Zone Prop. Corp.*, 1 A.D.2d 353, 149 N.Y.S.2d 840 (1956); *Giesecke v. Pittsburg Hotels*, 82 F.Supp. 64 (W.D.Pa.1949), *aff'd*, 180 F.2d 65 (3rd Cir. 1950). I have commented elsewhere in this opinion on other problems that can occur with this type of representation.

9. Experience, Reputation, and Ability of the Attorneys.

10. Undesirability of the Case.

11. Nature and Length of Professional Relationship with Client.

I have no doubts about the excellent experience, reputation, and ability of the attorneys as is evidenced by the high quality of their work present in this record. I believe the case was somewhat undesirable, not for the reasons cited by Plaintiffs in their brief, but because I feel Plaintiffs have and still are overestimating their chances of success on the merits at trial. I have not placed any special emphasis one way or the other in my award of fees and costs on any prior relationship with Plaintiffs' clients as it is undisputed that none existed prior to the institution of this suit.

12. Awards in Similar Cases.

I have already discussed my thoughts on this subject under *Customary Fees*, as these two categories, in my mind, overlap in this type of case. I am aware that a customary contingent fee in many cases is 33⅓ of the recovery, and that a number of cases apparently adopt this percentage as a proper means of determining the fee award. See, e. g., *Wolf v. Frank*, 555 F.2d 1213 (5th Cir. 1977); *Pearlman v. Feldmann*, 160 F.Supp. 310 (D.Conn.1958). I believe that each case must be evaluated on its own merits, taking into account what other courts have done in the past, but finally making an appropriate award for this case.

After considering all of these factors in relation to the Plaintiffs' request for fees and costs, I hereby award the Plaintiffs' fees in the amount of $167,780.00 and expenses in the amount of $72,300 to be paid from the settlement proceeds to the Plaintiffs, and after considering all of the Plaintiffs' objections, the briefs in the case, the settlement proposal, my expense and fee award to the Plaintiffs, the hearings conducted by the court, and all of the material on file in the record in this case I conclude that the settlement is fair, reasonable and adequate, that there is no evidence of collusion in the settlement, that the Board of Directors of Booth, Inc. did not lack independence or have a conflict of interest, that the Saner, Jack, Sallinger and Nichols law firm did not have a conflict of interest in representing Booth, Inc. in this litigation, and that the notice of the settlement should not have been sent to the NCS shareholders and that no settlement proceeds should go to former NCS shareholders as suggested by the Plaintiffs.

I hereby approve the settlement filed with the court on February 15, 1978 in all respects with the qualification that the Plaintiffs are awarded the fees and expenses set forth above from the settlement proceeds. I hereby sever the individual claims in this case, Counts I, II, V, and VI from the derivative claims involved in this settlement (Counts III, IV, VII, VIII, IX, X, XI, and XII), and hereby set for trial on the merits, specially set number one on the docket, Counts I, II, V and VI, on November 6, 1978, and I will enter a final judgment on the derivative counts by separate order. Under the provisions of Rule 54(b), Fed.R.Civ.Pro., I find that there is no just reason for delay in entering a final judgment as to the derivative claims in this case. I indicated in my Order of March 3, 1978 Tentatively Approving the Settlement that I would sever the derivative claims and enter a final judgment, and, as these claims are finally

settled and the settlement is completely independent of the individual claims in this case, I see no reason why I should not, as I indicated I would, enter a final judgment as to this part of the case.

I have taken longer that I had hoped to recount my reasons for reaching this result, but the ever expanding universe of paper, at least with respect to this portion of the litigation, is now drawing to a close, with a result that is favorable to Booth, Inc.

It is so ORDERED.

APPENDIX C

ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DENYING PLAINTIFFS' MOTION TO DISQUALIFY COUNSEL FOR BOOTH, INC.

Gearld CLARK, Tom Burden, Ronald Brandow, Robert Burnside and Wayne Burnside

v.

LOMAS & NETTLETON FINANCIAL CORPORATION, the Lomas & Nettleton Company, Lomas & Nettleton West, Inc., NCS Computing Corp., now known as Booth, Inc., Jess T. Hay, L & N Computer Services, Inc., John Sexton, Albert Rohnstedt, Dewitt T. Ray, Guy W. Rucker, Robert E. Glaze and James B. Gardner, et al.

No. CA3-7465-F.

79 F.R.D. 658 (N.D. Tex. 1978)

United States District Court,
N. D. Texas,
Dallas Division.

Aug. 7, 1978.

ROBERT W. PORTER, District Judge.

This lawsuit, filed on July 27, 1973, was brought derivatively on behalf of NCS Computing Corporation (as it existed prior to the merger of NCS and Booth, Inc. on May 10, 1973) by the Plaintiffs Gearld Clark, Ronald Brandow, Robert Burnside, Wayne Burnside and Tom Burden to recover damages for claims against Lomas and Nettleton

Financial Corporation and others which arose between 1969 and May 10, 1973. The Plaintiffs also assert individual claims for relief. The Court has ruled that as a matter of law this action is being brought derivatively on behalf of Booth, Inc. [See order of April 29, 1977, filed May 2, 1977, and my order entered today regarding settlement of the derivative claims in this case, Clark v. Lomas & Nettleton Financial Corp., 79 F.R.D. 641 (N.D.Tex.1978)].

On January 11, 1978 Plaintiffs moved to disqualify the Saner, Jack, Sallinger and Nichols law firm as counsel for Booth, Inc. Plaintiffs alleged that this law firm represented both Booth, Inc. and Defendant Directors Jack J. Booth, Martin Whitmer and Fladger Tannery until almost the eve of trial, and that this representation constituted a conflict of interest which should result in the disqualification of the Saner law firm and invalidate the settlement negotiated by that firm on behalf of Booth, Inc. At that time I ruled that I would not disqualify the Saner firm, and reserved final decision until now. Plaintiffs have now had an opportunity to conduct discovery regarding this alleged conflict of interest, and, at a hearing held June 5, 1978, Plaintiffs were afforded the opportunity to present witnesses to the court concerning this matter.

In a derivative action, a plaintiff shareholder is a nominal plaintiff and the corporation on behalf of which the action is brought is merely a nominal defendant. As the Court stated in *Miller v. American Telephone and Telegraph Co.*, 394 F.Supp. 58, 65 (E.D.Pa.1975), *aff'd without opinion*, 530 F.2d 964 (3rd Cir. 1976), "(a)lthough . . any corporation involved in a stockholders' derivative action . . . is properly made a nominal defendant, it must realistically be considered to be the complainant in the action." In fact, the corporation is the real plaintiff and any finding of liability would redound to its benefit, not to its detriment.

And, obviously, in this action any finding of liability on the part of the "inside" directors, controlling stockholder and the controlled corporations would result in a recovery for Booth, Inc. The interests of Booth, Inc. and the other Director defendants are clearly adverse, and the representation by one law firm of Booth, Inc. and the Directors, except under very limited circumstances, would be improper under the Canons of Ethics.

Canon 5 of the Code of Professional Responsibility and the applicable disciplinary Rule DR5-105 prohibit the representation of multiple clients with adverse interests. Code of Professional Responsibility Canon 5, DR5-105. The principles set forth in the canons and the rules apply to the possible disqualification of Booth, Inc.'s present counsel, and are completely discussed in *Cannon v. U. S. Acoustics Corp.*, 398 F.Supp. 209 (N.D.Ill.1975). The Seventh Circuit Court of Appeals affirmed that holding, in relevant part, "(f)or reasons expressed in the district court's able and scholarly opinion (citation omitted), which we adopt as our own . . ." 532 F.2d 1118, 1119 (7th Cir. 1976) (per curiam).

In *Cannon,* the court disqualified counsel from representing the corporation in a derivative action brought on its behalf, and at the same time representing individual officers and directors who were accused of various wrongdoings, allegedly for their own benefit and to the detriment of the corporation.

The court pointed out the conflict present when a lawyer seeks to represent both the corporation and the individual officers and directors accused of wrongdoing:

> "When a single lawyer or law firm undertakes to represent both the individual and corporate defendants in a derivative action, at least two potential ethical problems arise. First, there exists, as previously discussed, a poten-

tial conflict of interest between the individual and corporate defendants, and second, there is the threat that confidences and secrets obtained from each client may be jeopardized because of the dual nature of the representation." 398 F.Supp. at 215.

The court also noted that in Opinion 842 the Association of the Bar of New York Committee on Professional Ethics stated that whether or not the corporation takes an active role in the litigation, "a conflict of interest is inherent in any (derivative) action wherever relief is sought on behalf of the corporation against the individual director-officer defendants, and in such cases Canon 6 (presently Canon 5, EC 5-14 n.6 and 18) precludes one firm from representing both the corporation and the individual director-officer defendants except in unusual circumstances stemming from particular facts in a given case." (quoted *Id.*)

The *Cannon* decision was recently followed in the case of *Messing v. FDI, Inc.*, 439 F.Supp. 776, 782 (D.N.J.1977). See also *Niedermeyer v. Niedermeyer*, CCH Fed.Sec. L.Rep. (1973 Tranf. Binder) ¶94,123 at 94,502 (D.Ore.1973); *Lewis v. Shaffer Stores Co.*, 218 F.Supp. 238, 240 (S.D.N.Y.1963).

The facts in *Clark* do not present a conflict of interest that requires disqualification. Tim Kirk, a member of the firm Saner, Jack, Sallinger and Nichols, initially appeared on behalf of Booth, Inc. by filing an answer on Booth, Inc.'s behalf on January 14, 1974. He filed pleadings only on behalf of Booth, Inc. until January 21, 1977 when he filed "Defendant Booth, Inc., Tannery, J. Booth and Whitmer's Motion to Dismiss Counts 10 and 11 from Plaintiffs' Third Amended Original Complaint Pursuant to Rules 12(b)(6), 17(b) and 23.1 F.R.C.P." On July 1, 1977, after only filing memoranda supporting the motions to dismiss on behalf of the individual directors, Tim Kirk was replaced as counsel for the individual directors and Stan McMurray of Rain,

Harrell, Emery and Doke filed a "Motion to Dismiss, Motion for Judgment on the Pleadings, and Motion for Summary Judgment" on behalf of defendants Jack Booth, Fladger Tannery, Martin Whitmer and Guy Rucker. Thereafter all representation of these defendants, as can be seen from a review of the record, was in fact conducted by the Rain, Harrell firm although Tim Kirk and the Saner firm did not formally withdraw as counsel for the individual defendants Jack Booth, Fladger Tannery and Martin Whitmer until December 22, 1977. Booth, Inc. has always been represented by Tim Kirk in this litigation and he only represented Booth, Inc. in the settlement negotiations.

I find that there is no conflict of interest requiring disqualification in the narrow instance when one law firm represents a derivatively sued corporation and its individually sued directors and the law firm initially files a motion to dismiss on behalf of its clients, does not otherwise participate in the lawsuit, and withdraws from representation of either the corporation or the individual directors when either the motions to dismiss are overruled or when it becomes necessary to actively participate in the defense of the corporation and the individual directors. At this stage of the proceedings, when the court must make a determination on whether as a matter of law the defendants should be in the lawsuit, unless it can be shown that an actual conflict exists or that certain confidences are being jeopardized, I think the client's right to select the counsel of his choice outweighs any potential conflict of interest. Once that determination is made, or once it becomes necessary for active participation in the defense of the directors, then new counsel must be sought, because the potential for conflict has increased to the point where it outweighs the rights of the individual directors to select counsel. Of course, in that situation, the court, at the re-

quest of the individual defendants, may want to consider whether they can waive the conflict, but that is not an issue in this case because no one made that request of the court.

I find, under the circumstances present in this case, that the Saner firm did represent the individual directors only until the motions to dismiss were overruled or the defense of the directors required additional participation on behalf of the law firm in its representation of those directors. While it is true that technically Tim Kirk did not withdraw from representation of the individual directors until December 22, 1977, my concern is with the *actual* representation that occurred in this case and I find Tim Kirk did not actually represent the individual defendants for any period of time that would require disqualification.

I also note that Tim Kirk's alleged dual conflicting representation did not concern the Plaintiffs until after the settlement, to which they objected, was negotiated between Booth, Inc. and the Defendants. Only then, on January 11, 1978, did the Plaintiffs bring the matter to the attention of the court. I have found no conflict of interest warranting disqualification, but had I believed then or on January 11, 1978 that a conflict existed, I would hesitate to disqualify the Saner firm on Plaintiffs' untimely motion. From the record I can only conclude that the only reason Plaintiffs objected to the participation of the Saner firm in the lawsuit on January 11, 1978, when they could have objected to that representation for nearly a year, was to prevent the Court from approving what I have concluded is a fair, reasonable and adequate settlement. My responsibility in overseeing this derivative settlement, which I firmly believe to be in the best interests of all parties but particularly Booth, Inc., would not be properly exercised if I rejected this settlement on those grounds alone, without a showing, which has not been made in this record though Plaintiffs' have ample

opportunity to develop such a record, of how the conflict of interest (if there is one) resulted in a settlement that was unfair, unreasonable or inadequate for Booth, Inc.

Finally, if I believed that a conflict of interest had been shown and that the Saner firm should be disqualified for that reason without any showing that the conflict resulted in an unfair, unreasonable or inadequate settlement, I would still feel that I had a responsibility to approve the settlement which is fair reasonable and adequate and in the best interests of Booth, Inc.

Plaintiffs' motion to disqualify the firm of Saner, Jack, Sallinger and Nichols from representing Booth, Inc. is hereby denied in all respects.

It is so ORDERED.

APPENDIX D

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT DISMISSING PLAINTIFFS' APPEAL FROM AN INTERLOCUTORY ORDER

Gerald CLARK et al.,
Plaintiffs-Appellants,

v.

LOMAS & NETTLETON FINANCIAL CORPORATION et al.,
Defendants-Appellees.

581 F.2d 516 (5th Cir. 1978) (per curiam)

No. 78-1556

Summary Calendar.*

United States Court of Appeals,
Fifth Circuit.

Oct. 5, 1978.

Appeals from the United States District Court for the Northern District of Texas.

Before BROWN, Chief Judge, COLEMAN and VANCE, Circuit Judges.

PER CURIAM

This is a securities fraud case filed by stockholders of Booth, Inc., in the United States District Court for the Northern District of Texas. It includes both individual

*Rule 18, 5 Cir.; *see Isbell Enterprises, Inc. v. Citizens Casualty Co. of New York et al.*, 5 Cir., 1970, 431 F.2d 409, Part I.

claims and derivative claims asserted on the corporation's behalf, all arising out of alleged state and federal securities violations. This appeal is concerned only with the derivative aspect of the case.

Extensive discovery had been completed and trial was scheduled for January 16, 1978. Prior to that date, however, counsel for Booth, Inc. and counsel for the various other defendants, without participation by plaintiffs' counsel, reached a settlement agreement which was submitted to the district court for approval.

On March 3, 1978 the district court entered an order tentatively approving the settlement and setting June 5, 1978 as the date for hearing to determine whether the settlement should be given final approval. It is from that order, as amended by an order of April 3, 1978, that this appeal was taken.

Appellants also moved in this court for a stay of all proceedings pending this appeal. A like motion had been denied by the district court on March 17, 1978. On April 19, 1978 another panel of this court denied the motion with a written opinion.

Appellants now seek to present three contentions: (1) that the district court's non-communication order violated constitutionally protected rights of free speech and applicable federal rules; (2) that the non-communication order does not comply with the requirements of Rule 65, Fed.R.Civ.P.; and (3) that the trial court erred in refusing to order that notices of the proposed settlement and hearing be sent to pre-merger shareholders of Booth, Inc. The threshold question, however, is whether the order of March 3, 1978 is an appealable order. We conclude that it is not and therefore that the appeal is due to be dismissed.

In denying a stay the district court stated:

> In the near future all of the objections raised by the Plaintiffs to the proposed settlement will be aired in open court. The Court will have an opportunity to review the record on these objections and then enter an order approving or disapproving the settlement of the derivative claims. At that time Plaintiffs or Defendants may appeal the approval or denial of the settlement, which would include a final ruling on the disqualification of the SJS&N law firm. That order will be appealable as "final order", and will allow either side an opportunity to appeal the entire derivative case to the Fifth Circuit, with a complete record on appeal on all claims.

Similarly the panel of this court which denied a stay observed:

> Furthermore, the district court's disposition of these issues at the final settlement hearing will be reviewable upon appeal from that hearing.

The date in the "near future" to which the district judge referred was June 5, 1978, so that by this time the controversy may either by moot or may be moving in the direction of this court by proper appeal from an appealable judgment.

Both of the two theories on which appellants rely in seeking to support an appeal are obviously flawed. The non-communication order does not constitute an injunction within the meaning of Fed.R.Civ.P. 65 which is appealable pursuant to 28 U.S.C. § 1292(a)(1). *See Siebert v. Great Northern Development Company*, 494 F.2d 510, 511 (5th Cir. 1974); *Time, Inc. v. Ragano*, 427 F.2d 219 (5th Cir. 1970); *Weight Watchers of Phila. v. Weight Watchers Int.*, 455 F.2d 770, 774-775 (2nd Cir. 1972); *International Prod-*

ucts Corp. v. Koons, 325 F.2d 403, 406-407 (2nd Cir. 1963). It is equally clear that the order is not appealable under the collateral order exception of *Cohen v. Beneficial Loan Corp.*, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528 (1949). Even if we conclude that the order is final and collateral the order before us falls far short of meeting the remaining requirements contemplated by *Cohen*. *See Western Elec. Co. v. Milgo Electronics Corp.*, 568 F.2d 1203 (5th Cir. 1978); *In Re Nissan Motor Corp. Antitrust Litigation*, 552 F.2d 1088, 1094-1095 (5th Cir. 1977).

The prior panel noted that appellants raise issues that cast doubts on the validity of the district court's actions. We agree that the questions are substantial. The circumstances here, however, clearly do no justify their presentation by piecemeal review.

APPEAL DISMISSED.

APPENDIX E

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT VACATING AND REMANDING CAUSE TO THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 78-2973

D. C. Docket No. CA-3-7465-F

GERALD CLARK, Et Al.,
Plaintiffs-Appellants,

VERSUS

LOMAS & NETTLETON FINANCIAL CORPORATION, Et Al.,
Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS BEFORE SIMPSON, HILL AND HATCHETT, CIRCUIT JUDGES.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, vacated; and that this cause be, and the same is hereby remanded to the said District Court in accordance with the opinion of this Court;

It is further ordered that defendants-appellees pay to the plaintiffs-appellants the costs on appeal, to be taxed by the Clerk of this Court.

August 28, 1980

Issued as Mandate:

APPENDIX F

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT DENYING APPELLANTS' PETITION FOR REHEARING AND REJECTING SUGGESTION FOR REHEARING EN BANC

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 78-2973

GERALD CLARK, Et Al.,

Plaintiffs-Appellants,

VERSUS

LOMAS & NETTLETON FINANCIAL CORPORATION, Et Al.,

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

ON PETITIONS FOR REHEARING AND PETITIONS FOR REHEARING EN BANC

(Opinion 8-28-80, 5 Cir., 197 , F.2d).

(November 7, 1980)

Before SIMPSON, HILL and HATCHETT, Circuit Judges.

PER CURIAM:

(✓) The Petitions for Rehearing on behalf of Certain Appellees, Appellee Booth and Appellees Glaze and Crow

are DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16) the Petitions for Rehearing En Banc are DENIED.

( ) The Petitions for Rehearing are DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16) the Petitions for Rehearing En Banc are also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideartion of this cause en banc, and a majority of the judges in active service not having voted in favor of it, rehearing en banc is DENIED.

Entered for the court:

JAMES C. HILL

United States Circuit Judge

CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing petition for writ of certiorari has been forwarded to all counsel of record listed below, this 10 day of December, 1980:

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